



Australian Government

Independent Review of the Franchising Code of Conduct

Dr Michael Schaper

December 2023



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Glossary

AADA	Australian Automotive Dealers Association
AAF	Australian Association of Franchisees
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law (Schedule 2, <i>Competition and Consumer Act 2010</i> (Cth))
ADR	Alternative Dispute Resolution
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
AFCA	Australian Financial Complaints Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CCA	<i>Competition and Consumer Act 2010</i> (Cth)
CALD	Culturally and Linguistically Diverse
Code	Franchising Code of Conduct (Schedule 1 to the <i>Competition and Consumer (Industry Codes – Franchising) Regulation 2014</i> (Cth)).
FCA	Franchise Council of Australia
FCAI	Federal Chamber of Automotive Industries
FDR	Franchise Disclosure Register
KFS	Key Facts Sheet
MTAA	Motor Trades Association Australia
OEM	Original Equipment Manufacturer
PJC	Parliamentary Joint Committee on Corporations and Financial Services
SBTC	Small Business Tax Concierge service
UCT	Unfair Contract Terms protections as set out in the ACL (Part 2–3, Schedule 2, <i>Competition and Consumer Act 2010</i> (Cth))

Letter of transmittal

11 December 2023

The Hon Julie Collins MP
Minister for Small Business
Parliament House
CANBERRA ACT 2600

Dear Minister

I am pleased to submit the report of the Independent Review of the Franchising Code of Conduct.

In accordance with the review's terms of reference, I have assessed the fitness for purpose of the Code, with particular regard to the provisions relating to new vehicle dealerships and the operation of the Franchise Disclosure Register (FDR). I have done so with regard to other relevant policy reviews and changes, including the recent strengthening of unfair contract terms laws, current consultations underway on potential new unfair trading practices laws, and the work of the government's Competition Taskforce.

The central challenge facing franchising regulators is to provide clarity and guidance to sector participants about the respective rights and responsibilities of all parties; to ensure there is a reasonable opportunity for both franchisees and franchisors to benefit from their relationship; and to encourage a level of self-responsibility by all parties. The Code, like other frameworks which support competitive and fair market conduct, should not be overly prescriptive or attempt to guide all actions by sector participants. It must also continue to support entrepreneurial innovation and flexibility so that the notion of franchising remains viable well into the future.

The review benefited from strong engagement from across the franchise sector. I am thankful to all parties involved for the constructive and professional manner in which they have engaged with myself and the review secretariat.

It is clear that almost all parties see merit in the continued operation of the Code in some form. In general, the benefits of the regulatory framework set out in the Code continue to outweigh the regulatory costs imposed. As such, the Code should be remade, and not be allowed to sunset in April 2025. Nevertheless, some changes are needed to the existing provisions, and as such I have made a number of recommendations for changes for government to consider when remaking the Code.

Beyond the immediate imperative to remake the Code prior to sunset, I have also recommended that further work be done to evaluate the merit of introducing a possible licensing (*ex ante*) approach rather than continuing solely with the existing *ex post* regulatory regime. There has been increasing discussion amongst the sector about the desirability of a more fundamental shift in regulatory approach, to address persistent issues in the sector without necessarily imposing a greater degree of complexity or regulatory burden than the current Code. However, a comprehensive analysis is needed before embarking on such a fundamental shift.

Finally, I would like to thank the Treasury secretariat (Rhiannon Kerin, Joshua Leach, Nicole Hoffman and Phoebe Butcher) for their highly professional support, analysis and management of the review.

I wish the Government well in its deliberations regarding the review recommendations and thank you for the opportunity to complete this important piece of work.

Yours sincerely

A handwritten signature in black ink, appearing to read 'M Schaper', written in a cursive style.

Dr Michael Schaper
Independent Reviewer

Terms of reference

On the 15th of August 2023 the following Terms of Reference were issued by Minister for Small Business, the Hon Julie Collins MP.

Franchising is an important contributor to the Australian economy. The regulatory framework that underpins the relationship between franchisors and franchisees is critical to ensuring confidence in the sector. It should promote positive commercial relationships, fair trade and not unduly restrict competitive conduct. Reviews provide an important opportunity to evaluate the effectiveness of regulatory frameworks. To meet the requirements of statutory and other review requirements in relation to franchising, a review process is to commence in the second half of 2023.

The review will have regard to the following:

- Noting that the Franchising Code is due to sunset on 1 April 2025, the general fitness for purpose of the Franchising Code.
- The role of the Australian Competition and Consumer Commission and the Australian Small Business and Family Enterprise Ombudsman in supporting enforcement and dispute resolution under the franchising regulatory framework.
- The role of the Franchising Code in regulating the automotive sector, including:
 - Whether Franchising Code protections available to automotive franchisees should be extended beyond new car dealerships (for example to truck, motorcycle, and farm machinery dealerships).
 - The effectiveness of 2020 and 2021 reforms which:
 - : provided for multi-party dispute resolution and clarified that agency models are captured by the Franchising Code.
 - : created new obligations relating to compensation in the event of early termination, and franchisees' capacity to make a return on investment.
 - : provided additional protections to apply at the end of a franchise term including notification requirements and processes for winding down.
 - : restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure.
 - : clarified the operation of the Franchising Code obligation to act in good faith in relation to new car dealerships.
 - The impact of 2022 reforms which increased certain penalties available under the Franchising Code to: the greater of \$10 million, 3 times the benefit obtained, or 10% of annual turnover.
 - From 15 November 2023, which will mark when the Register has been publicly available for one year, provisions in the Franchising Code related to the Franchise Disclosure Register.

The review process will be informed by consultation which allows all interested parties to make submissions.

A report that includes appropriate findings and recommendations will be prepared. The report will be provided to the Minister for Small Business, the Hon Julie Collins MP, no later than the end of December 2023.

Where required, the report will be assessed against the criteria for a post implementation review, as set out in the Australian Government Guide to Policy Impact Analysis.

Executive summary

The franchise sector in Australia currently contains 1,144 franchise systems and some 70,735 franchisees. Collectively the sector employs 522,877 people, turning over an estimated \$135.2 billion in 2023, highlighting the importance of the sector to the Australian economy. The majority of franchisors and almost all franchisees are small businesses. However, in recent years growth in the size of the sector has lagged that within the broader small business population.¹

The review ran from August to December 2023. Given the lack of a robust system of comprehensive statistics about the sector and the level of disputation within it, most of its work was based on wide public consultation with interested parties. An initial consultation paper was published on 22 August 2023, and meetings were subsequently held with a range of stakeholders. Over 40 meetings and roundtables were held, and 95 submissions were received. Input was also sought from the sector through two surveys. The first, a survey of franchisees, received 381 responses. The second, a survey on the Franchise Disclosure Register (FDR), received 163 responses. The Australian Bureau of Statistics (ABS) also produced analysis to support the review.

The review found that the Franchising Code of Conduct is generally fit for purpose and should be remade. However, some changes are needed to the existing Code provisions. For example, some protections for new vehicle dealerships should be extended to all franchisees. There are also opportunities to improve the broader operating environment for the sector, for example through enhanced delivery of government information and guidance on best practice.

Additionally, the review has recommended that further consideration should be given to a more fundamental change through the introduction of a licensing (*ex ante*) approach, rather than continuing solely with the existing *ex post* regulatory regime. *Ex ante* reform may address persistent issues in the sector without necessarily imposing a greater degree of complexity or regulatory burden than the current Code. However, a comprehensive analysis is needed before embarking on such a fundamental shift.

1 Further discussion on these characteristics, together with data sources, is included in chapter 1 of the review report.

Findings and recommendations

About the franchising sector

Findings	
I.	The size of the franchise sector has not kept pace with the rate of growth in the broader business population.
II.	Current statistics about the demography of the franchise sector, and metrics by which success can be measured, need to be improved.
Recommendations	Implementation suggestions
1.	The Australian Government should ensure the provision of more comprehensive, robust statistics about the franchising sector.
	1A. The Commonwealth Treasury should drive a cohesive approach to data collection regarding the franchising sector. It should leverage the FDR and existing data collection and expertise within the ABS, ACCC, ASBFEO, state small business commissioners and other relevant government bodies.
	1B. Surveys conducted for this review should be repeated in the future to improve longitudinal data collection regarding the sector.

Scope and structure of the Code

Findings	
III.	The Code is generally fit for purpose.
IV.	There is significant misunderstanding, especially amongst franchisees, about what the Code is meant to achieve. The current articulation of the purpose of the Code in Clause 2 does not adequately explain to readers why the Code exists, what it seeks to achieve, and what it does not cover.
V.	Amendments made to the Code in 2022 to exempt cooperatives and mutual entities are effective and have not produced any unintended consequences.
VI.	Part 5 of the Code relating to new vehicle dealerships is operating as intended and not producing any unintended consequences.
VII.	The sector requires some respite from a constant process of review.
Recommendations	Implementation suggestions
2.	The Code should be remade, largely in its current format.
	2A. Retain the Code, subject to the suggestions for change set out in recommendations below.
	2B. When remaking the Code, the technical and drafting issues raised in Appendix A should be considered.
3.	A clear statement of purpose should be inserted into the Code.
	3A. The Code should be amended to explicitly state why it exists and what it seeks to achieve. A clear articulation that the Code is intended to <i>improve standards of conduct and ensure access to information and dispute resolution</i> , rather than <i>eliminate all misconduct or risk</i> , would clarify the expectations of franchisees regarding the extent of protection intended.
4.	Service and repair work conducted by motor vehicle dealerships should be explicitly captured by the Code.
	4A. The definition of motor vehicle dealership in the Code should be amended to clarify that it includes all sales, service and repair work.
5.	Reviews of the Code should be conducted in five yearly cycles in the future.
	5A. To provide certainty to the sector, the timing of a mid-term review (that is, five years after the Code is remade noting it will sunset after 10 years) could be provided for in a statutory provision of the Code.
	5B. The next review of the Code should consider whether Part 5 should be retained and, if so, whether it should be extended to other subsectors such as trucks, farm machinery and motorcycles.

Entering into a franchise agreement

Findings	
VIII.	The Code requirements relating to disclosure are comprehensive. They can sometimes be burdensome for franchisors to comply with, and burdensome for franchisees to comprehend and act on. Any further attempt to address concerns by mandating greater disclosure is likely to be counterproductive.
IX.	Certain disclosure and cooling off obligations in the Code create unnecessary regulatory burden when applied to the renewal of an existing franchise relationship.
X.	It is impractical to mandate compulsory pre-entry education and advice, however enhancements to education and advice by government would be beneficial.
XI.	All franchise agreements ought to provide a reasonable opportunity to make a return on investment (including provision for compensation in the event of early termination).
XII.	The FDR is a valuable addition to the regulatory landscape, but awareness and utilisation of the Register is low and greater enforcement of the listing requirements is likely to be needed.
Recommendations	Implementation suggestions
6.	Simplify and consolidate the pre-entry information given to prospective franchisees.
7.	Franchisor obligations under the Code in relation to existing franchisees should be simplified.
8.	The existing requirement that new vehicle dealership agreements must provide a reasonable opportunity to make a return on investment should be extended to all franchise agreements.
9.	The existing requirement that new vehicle dealership agreements must include provisions for compensation for franchisees in the event of early termination should be extended to all franchise agreements.
10.	Enhance the public visibility and usage of the Franchise Disclosure Register.
11.	Additional information should be included on the FDR relating to dispute resolution and adverse actions brought by enforcement agencies.
6A.	Merge the disclosure document and key facts sheet.
7A.	Existing franchisees entering into a new franchise agreement (or renewing or extending an existing agreement) should be able to opt out of disclosure and cooling off requirements designed to protect new franchisees.
8A.	Amend Clause 46B of the Code to apply to all franchise agreements, not just new vehicle dealership agreements.
9A.	Amend Clause 46A of the Code to apply to all franchise agreements, not just new vehicle dealership agreements.
10A.	More actively promote the FDR's existence and usage through education material prepared by business.gov.au, the ACCC, ASBFEO and state SBCs.
10B.	Responsibility for the administration of the FDR and its website should sit with the ACCC.
10C.	If a FranchiseSmart website model is adopted, incorporate the FDR into FranchiseSmart.
11A.	The FDR should state whether or not a franchise system offers binding voluntary arbitration.
11B.	Consideration should be given to including information on the FDR about any sanctions or court action taken by the ACCC, ASIC, FWO or ATO against a franchise system in the last five years.

During a franchise relationship

Findings	
XIII. Over time, decisions made by the courts are providing guidance to franchisors and franchisees on what is required to act in good faith under the Code. Such decisions should be used by regulators to develop education, particularly for franchisees, as to the limitations of good faith in a grievance.	
XIV. Change management continues to be a problematic area for many franchise relationships.	
XV. Some franchisors are not employing best practice relating to the transparent and effective operation of marketing and cooperative funds.	
Recommendations	Implementation suggestions
12. Franchise systems should be encouraged, through education, to consult franchisees regarding any major change to the business model during the term of the franchise agreement.	12A. Relevant Australian Government agencies should support franchisor-targeted education and provide best practice guidance on how to manage change and support productive working relationships with franchisees. Sector participants could work together with the ACCC and ASBFEO to develop appropriate guidance.

Ending a franchise relationship

Findings	
XVI. Changes made in 2021 relating to delayed termination have made it unacceptably difficult for franchisors to act decisively in the context of serious breaches.	
XVII. There needs to be more awareness and clarity regarding the process and circumstances in which a franchisee can negotiate an early exit from a franchise agreement.	
XVIII. Misunderstanding of goodwill in franchising continues to be a source of complaints that arise at the end of an agreement. Goodwill issues are driven by concerns relating to adequate compensation, uncertainty, and the opportunity to make a return on investment.	
XIX. Unreasonable – and unenforceable – restraints of trade are unduly limiting franchisee opportunities at the end of a franchise relationship. While many existing restraints of trade terms may be difficult to enforce, they may unduly inhibit and dissuade competition in the sector.	
Recommendations	Implementation suggestions
13. Provisions relating to termination for serious breaches should be simplified. Changes made in 2021 relating to termination under clause 29 of the Code should be revisited.	13A. The Australian Government should consult the sector when re-making the Code on options for simplifying these provisions without diminishing protection for franchisees. Options could include strengthening the rights of franchisors to terminate immediately if appropriate compensation is paid to a franchisee.
14. Best practice guidance should be provided to franchisees and franchisors regarding franchisee-initiated exit, to enhance the effectiveness of clause 26B of the Code.	14A. Guidance could take the form of resources produced in consultation with ACCC and ASBFEO regarding minimum standards and best practices. These resources could be housed on the proposed FranchiseSmart website.
15. Further work should be done to limit the use of unreasonable restraints of trade in franchise agreements.	15A. The Australian Government's Competition Taskforce should consider how to limit the use of restraints of trade and other uncompetitive terms in franchise agreements. 15B. The ACCC should issue guidance on when a restraint of trade may constitute an unfair contract term.

Regulatory oversight and dispute resolution

Findings	
XX.	The existing approach to online education and advice resources for the franchising sector is not optimal. The spread of resources across the ACCC, ASBFEO, business.gov.au and Treasury websites increases search costs for participants in the sector and decreases the chance that the resources will be utilised.
XXI.	The needs of indigenous and CALD communities are not currently well considered in education and outreach.
XXII.	Franchisees would benefit from greater access to early advice on the merits of their claim against a franchisor. ASBFEO's existing Small Business Tax Concierge Service provides a useful model as to how this might work.
XXIII.	Powers for ASBFEO to name franchisors who have not meaningfully participated in dispute resolution mechanisms can be a useful tool.
XXIV.	Code compliance would be enhanced by increasing both the number of penalty provisions and the capacity to issue infringement notices.
XXV.	While the current Code remains fit for purpose, it would be beneficial to examine the merits and feasibility of a shift to an ex ante licensing regime prior to the next review of the Code.
Recommendations	Implementation suggestions
16.	A comprehensive online government resource should be created, in the nature of ASIC's MoneySmart website ('FranchiseSmart website').
	16A. Primary responsibility for this site could rest with the principal regulator, the ACCC. The ACCC could work with content creators for business.gov.au, ASBFEO and other relevant government agencies to collate relevant information in a user-friendly manner.
	16B. Special regard should be made to the needs of CALD and First Nations audiences.
17.	Australian Government agencies should work with relevant sector participants to improve standards of conduct in franchising by developing best practice guidance and education.
	17A. Best practice guides could be developed by ASBFEO and the ACCC and other agencies as relevant. Guides could be housed on the proposed FranchiseSmart website.
	17B. Initial matters for best practice guidance could include change management, the operation of marketing funds, supporting franchisees who wish to exit, and how to effectively participate in voluntary arbitration and multi-party dispute resolution.
	17C. Such guidance and education should ensure that the franchising sector is adequately informed about the impact of the new UCT provisions and any new unfair trading practice laws.
18.	ASBFEO should be given additional powers to name franchisors who have not participated meaningfully in alternative dispute resolution.
	18A. ASBFEO's functions under the regulations that prescribe the Code could be expanded to include adverse publicity powers similar to those under section 74 of the <i>Australian Small Business and Family Enterprise Ombudsman Act 2015</i> (Cth).
19.	The Australian Government should assist franchisees to access low-cost legal advice on prospects prior to formal ADR.
	19A. ASBFEO's Small Business Tax Concierge function could be renamed and expanded to allow franchisees to access low-cost advice on their case prior to entering formal mediation.
20.	The Australian Government should consider an appropriate role for franchise interests when implementing its commitment to a designated complaints function for the ACCC.
	20A. Consideration should be given to ASBFEO being a designated complainant.
21.	Franchisees should be able to seek a 'no adverse costs' order when bringing a matter against a franchisor for breach of the Code or the Australian Consumer Law.
	21A. Subsection 82(3) of the CCA could be amended to provide that applications for no adverse costs orders can be made in relation to contraventions of Part IVB and the ACL.

Recommendations	Implementation suggestions
22. The scope of penalties under the Code and associated investigation powers and infringement notice regime in Part IVB of the CCA should be increased.	22A. All substantive obligations placed on parties under the Code and in Division 5 of Part IVB of the CCA should be penalty provisions. 22B. Infringement notices should impose a penalty equivalent to the upper limit of infringement notices issued under the ACL (60 penalty units for a body corporate).
23. The Australian Government should investigate the feasibility of introducing a licensing regime to better regulate most aspects of the franchisee-franchisor relationship.	23A. Representatives of franchisees, franchisors and relevant government agencies including the ACCC should play a key role in examining this issue.

Chapter 1: About the franchising sector

Franchising in Australia involves one person (the franchisor) granting another person (the franchisee) the right to operate a business according to the franchisor's systems and marketing plan. The business must be associated with a brand belonging to the franchisor, and the franchisee must make payment to the franchisor or its associate. There are numerous variants of this basic model, and a wide variety of different contractual and operating models across the franchising sector.²

The franchising sector is a significant contributor to Australia's economy, involving a large number of firms, owners and employees, and providing a wide range of products and services to consumers. Any examination of the current regulatory regime must be based on an understanding of these features and issues.

As such, this chapter of the report provides background information on:

- Characteristics of the Australian franchising sector
- Findings from surveys conducted for the review
- Specific demographic information regarding the automotive sector
- Trends impacting the sector
- Limitations of existing data
- Current regulatory framework
- History of regulation and review.

1.1 Characteristics of the Australian franchising sector

Australia is a nation with significant franchising activity. While estimates of the number of franchise systems in Australia vary, the FDR provides a relatively complete picture of the franchising sector. Based on FDR data, the ABS concluded that there are an estimated 1,144 franchise systems operating in Australia.³ Within these 1,144 franchise systems there are 70,735 franchisees.⁴ The franchising sector is forecast to generate an annual revenue of \$135.2 billion in 2023 and provide work for around 522,877 individuals.⁵

2 For example, many franchise systems operate across multiple tiers, and many franchisors appoint a 'subfranchisor' to appoint franchisees in a particular region. Subfranchisors are also sometimes referred to as 'master franchisees'. The original franchisor in such systems is usually known as the 'master franchisor'.

3 Australian Bureau of Statistics (ABS), *Franchisor Business Demographics: Business Register Unit, Statistical Infrastructure Division*, report to the Australian Government Department of the Treasury, November 2023, p 2. *Note:* with many systems operating with subfranchisor arrangements, the total number of franchisor entities on the FDR is significantly higher at 1,712 franchisor entities as of September 2023.

4 *Franchise Disclosure Register* [data set], <https://franchisedisclosure.gov.au>, 2023, accessed 14 September 2023.

5 Figures were calculated using: IBISWorld, *Franchising in Australia – Market Size, Industry Analysis, Trends and Forecasts (2023–2028)*, IBISWorld website, May 2023, accessed 20 October 2023; IBISWorld, *Fuel Retailing in Australia – Market Size, Industry Analysis, Trends and Forecasts (2023–2028)*, IBISWorld website, May 2023, accessed 20 October 2023. Noting that IBISWorld's Franchising in Australia report includes fuel retailing, these figures have been adjusted to exclude franchised fuel retailing. The custom fuel retailing turnover excludes major fuel brands that do not operate franchise systems in Australia.

Many franchisors are small enterprises, and 3 quarters of franchisors have 16 or fewer franchisees.⁶ However, 80.4% of franchisees are found in large or complex franchise systems. In other words, there is a significant Pareto-style distribution which demonstrates that most franchisees do experience an imbalance of power and resources in franchisor interactions.

Franchise models are most frequently found in the ‘retail trade’ and ‘accommodation and food services’ sectors. ABS analysis indicates estimated 269 franchise systems operating in the retail trade sector (18,249 franchisees), followed by 184 franchise systems in accommodation and food services (7,438 franchisees).⁷

The number of franchisor and franchisee units in existence displays some unusual characteristics, especially compared to the broader Australian business population. The number of franchise systems has generally remained stable over the past 10 years, with estimates fluctuating between 1,160 and 1,144 for the period of 2014 to 2023. However, the total number of franchisees marginally declined by about 5.2% from 74,598 in 2014 to 70,735 in 2023.⁸ In comparison, the overall number of businesses in Australia grew by about 28% between 2014 and 2023.⁹ This trend suggests a relative downturn in the use of the franchise model over the past decade. This is consistent with estimates of ‘industry value added’ (IVA) which have also fallen over a 10 year period. IVA, which measures the industry’s contribution to the overall economy, is forecast to decrease at an annualised 0.9%, compared with annualised growth in Australian GDP of 2.1% over the same period. As a result, the industry is projected to significantly underperform the wider economy.¹⁰ Trends impacting the sector which may have contributed to this relative decline are discussed further below.

There is relatively limited data available providing insights into the relationship between franchisors and franchisees. Data regarding the level of complaints and disputation is discussed in detail in Regulatory oversight and dispute resolution, however this is likely to be an incomplete picture; for example, while the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) actively managed 150 franchising disputes in the 12 months to June 2023 – suggesting a disputation rate of 0.2% – over 33% of respondents to the franchisee survey (see below) reported that they had a serious dispute with their franchisor in the last 12 months. Other insights from sector stakeholders suggest a relationship between the amount of time a franchisee has been operating and their level of satisfaction; it is reported that franchisees typically experience an initial ‘honeymoon period’ where they are quite satisfied, followed by a typical decline in satisfaction during the initial years, stabilising around the five to seven-year mark, followed by a gradual increase thereafter.¹¹

6 *Franchise Disclosure Register* [data set], <https://franchisedisclosure.gov.au>, 2023, accessed 14 September 2023.

7 ABS, *Franchisor Business Demographics*, p 9.

8 The 2014 figures are calculated from Frazer et al., *Franchising Australia* 2014, Asia-Pacific Centre for Franchising Excellence, 2014, p 16.; the 2023 figures are sourced from the Department of the Treasury, *Franchise Disclosure Register* [data set], <https://franchisedisclosure.gov.au>, 2023, accessed 14 September 2023.

9 Figures calculated using: ABS (August 2023), *Counts of Australian Businesses, including Entries and Exits* [data set], <https://www.abs.gov.au>, accessed 22 November 2023.

10 IBISWorld, *Franchising in Australia*, industry report series, catalogue number X0002, IBISWorld, May 2023, p 36. ‘Industry value added’ has dropped from \$50,024 million in 2013–14 to \$44,687 million in 2022–23.

11 G Nathan, *An Empirical Study on How Psychosocial Factors Impact on the Franchise Relationship*, Franchise Relationships Institute, 2022, p 23.

Automotive sector

Since 2021, Part 5 of the Code has contained unique protections for new vehicle dealerships which do not apply to any other forms of franchising. However, other types of automotive franchisees are still captured by the general provisions of the Code. The terms of reference for the review require consideration of whether the protections that apply to new car vehicle dealerships should be extended beyond new car dealerships (for example to truck, motorcycle, and farm machinery dealerships). Table 1 below provides key industry demographics for car dealerships and the other sectors mentioned in the terms of reference.

Table 1: Industry demographics for key automotive subsectors

Dealer type	Cars	Trucks	Motorcycles	Farm/construction machinery
Revenue (\$bn)	64.7	5.7	1.8	23.4
Employees	68,429	6,667	3,785	25,908
Businesses	4,373	462	697	1,672
Average Business revenue (\$m)	14.8	12.3	2.6	14
Average number of employees per business ¹²	16	14	5	15

Data sourced primarily from IBISWorld.¹³

1.2 Surveys conducted for the review

Two surveys of franchising sector stakeholders were conducted during the review:

- From 4 to 20 October a franchisee survey was conducted. This received a total of 381 responses
- From 15 to 26 November a survey seeking views on the FDR was sent to all registered franchisors and promoted on the FDR homepage to public users. This received a total of 163 responses.

These surveys facilitated the collection of standardised, quantifiable data, allowing for comparative analyses. Incorporating these targeted stakeholder surveys, alongside formal submissions, into the review process has improved the calibre of evidence examined.

Franchisee survey

The franchisee survey asked 15 questions relating to views on the regulatory framework, the role of Australian Competition and Consumer Commission (ACCC) and ASBFEO, and the franchisee-franchisor

¹² In practice many dealerships have common corporate ownership and as such the number of employees per dealership group are often much higher.

¹³ For the comparison, data was drawn from: IBISWorld, *Motor Vehicle Dealers in Australia*, industry reports series, catalogue number G3911, IBISWorld, June 2023; IBISWorld, *Motorcycle Dealers in Australia*, industry reports series, catalogue number G3912, IBISWorld, July 2023; IBISWorld, *Truck Dealers in Australia*, industry reports series, catalogue number OD4031, IBISWorld, September 2023. Note: not all dealerships in the Table 1 figures are franchised. These numbers likely include non-franchised vehicle dealerships. For example, the Australian Automotive Dealers Association (AADA) estimates there are 3,026 franchised new motor vehicle dealerships (see *AADA Automotive Statistics*, AADA, 2023, p 7).

relationship. Franchisees were also provided with the opportunity to provide a free text response to the question: *'If you could change one thing about the rules for franchising, what would it be?'*

Responses to the survey were completed by franchisees with a range of characteristics, however the typical respondent was a franchisee with over 3 years' experience. There was significant representation from motor vehicle dealerships (173/381 responses). A summary of key findings appears in Table 2 below. These findings are discussed in more detail where relevant in subsequent chapters of this report. A full copy of the survey findings is included at Appendix B.

Table 2: Key findings from the franchisee survey

Views on the Code	Franchisees' average rating for their knowledge of the Code was 6.3/10. Franchisees' average rating for effectiveness of the Code was 4.2/10. The most common view was that 'too much information' was provided during disclosure; this was followed closely by 'the right amount'.
Relationship with franchisor	Franchisees' average rating for their working relationship with their franchisor was 5.7/10. 126 franchisees reported that they had a serious dispute with their franchisor in the last 12 months; only 12 of these 126 respondents said they were able to resolve the dispute effectively.
ASBFEO and the ACCC	More franchisees were aware of the role of ASBFEO and the ACCC than not aware. Franchisees' average rating for effectiveness of the ACCC was 4.0/10.

Franchise Disclosure Register survey

The FDR survey directed questions to both franchisor and franchisee audiences. Questions directed to franchisors generally sought views on the effectiveness of the FDR as a tool to meet regulatory obligations imposed by the Code. Questions directed to franchisees and other public users generally sought views on how valuable they found the FDR. Respondents were also invited to respond with free text providing 'any other feedback' on the FDR.

The FDR survey was predominantly completed by franchisors and their advisors (144/163 responses). The limited number of responses from franchisees and their advisors limits the statistical value of responses to certain questions but may itself be a useful indicator of low FDR awareness among franchisees and prospective franchisees. A summary of key findings appears in Table 3 below. These findings are discussed in more detail where relevant in subsequent chapters of this report, particularly Chapter 4. A full copy of the survey findings is included at Appendix C.

Table 3: Key findings from the FDR survey

Franchisor insights	Most franchisors considered the information required to be included on the FDR 'the right amount of information' (42%), followed closely by 'too much information' (38%). Most franchisors who had not voluntarily uploaded documents to the FDR cited confidentiality concerns (71%). 68% of respondents sought legal advice to assist with meeting their obligations relating to the FDR; most franchisors learned about the FDR from professional advisors. In terms of the usability of the FDR, around half of users perceived the FDR to be 'about the same' or 'easier to use' than other government registration process.
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1.3 Trends impacting on the sector

There are a number of emerging trends and challenges that are reshaping the franchising landscape in Australia. While the sector faces the same economic challenges encountered by all businesses in Australia, such as skills and labor shortages, rising costs of doing business, and increasing cyber security threats, there are a number of specific trends that pose challenges and opportunities unique to the sector.

The rise of gig economy models, characterised by flexible, short-term jobs, poses a competitive threat to traditional franchising models, particularly in service industries. Platforms such as Uber and Airtasker have low barriers to entry and provide greater work flexibility and lower initial investment for individuals who are looking for ways to engage in supported self-employment and may otherwise have considered franchising.

The growth of direct-to-consumer models, facilitated by digital platforms, is disrupting traditional retail and service franchise models by enabling manufacturers and service providers to interact directly with consumers.

New agency models, where agents operate under a brand but with more autonomy than traditional franchisees, are emerging as a middle ground between franchising and independent operations.

A significant trend is the integration of advanced technologies. The sector is increasingly adopting digital transformation strategies, including online marketing, data analytics, and artificial intelligence. These services may challenge some existing franchise brands. However, these technologies also provide an opportunity to streamline operations and may enable franchises to offer personalised customer experiences, improve operational efficiencies and increase customer engagement.

Franchise brands operating in retail shopping centres face high rents and complexity with franchisee leases. As retail continues to evolve, there may be a greater move to online sales, which may also pose an issue with franchisee territory exclusivity.

There is a shift in consumer preferences towards sustainability and health-conscious offerings. Opportunities for franchise business to expand into eco-friendly products or services that promote health, wellness and sustainability are likely to increase over the next decade.

Trends unique to the automotive sector

The automotive sector is experiencing a trend of consolidation. The top 4 automotive dealers have doubled their market share over the past five years.¹⁴ The automotive sector is also facing increasing demand from consumers for electric and hybrid vehicles. Technological innovations (for example, autonomous features) are increasingly disrupting business models within the automotive sector. Additionally, there is a notable shift towards online engagement, sales, and digital marketing strategies.

The automotive industry has experienced a period of relatively profitable operation due to demand outstripping supply, caused by the COVID-19 pandemic's disruptions to the economy.

14 IBISWorld, *Motor Vehicle Dealers in Australia*, p 25.

However, this growth is expected to stabilise with new car sales forecasted to grow by only 2.2% annually from 2023–2028.¹⁵

Entry barriers into the industry are high due to the substantial capital requirements and the tendency for the original equipment manufacturer (OEM), distributors, and dealers to transact within existing networks. Intensifying levels of competition from newer brands and evolving business models could lower these barriers.

Truck dealerships exhibit low market concentration, with the top 4 truck dealers contributing less than 20% of industry revenue.¹⁶ High entry barriers, including substantial capital demands and extensive industry expertise, characterise the truck dealerships sector.

1.4 Limitations of existing data

The best regulatory frameworks are informed by a clear purpose with metrics for measuring success. Despite the prominence of franchising in Australia, there is an absence of substantial data collected by public or private bodies. Much data is drawn from particular industries, limited samples or by extrapolation. While individual sector bodies and the ABS prepare some material, there is no comprehensive, longitudinal and reliable data set publicly available. This limits the capacity of policymakers and the franchise community to fully understand the sector and the true level of disputation within it. Information about the franchising behaviours of particular subsectors or groups (including First Nations peoples, culturally and linguistically diverse (CALD) groups, and those living with a disability) are even harder to find. More comprehensive data regarding the experience of franchisees in Australia would be highly valuable, including insights into the relationship dynamics found between franchisors and franchisees.

There are opportunities to further bolster the evidence base for informed policy decisions and regulatory assessments. The FDR, established in 2022 and maintained by the Commonwealth Treasury, provides valuable insights into the franchising sector in Australia. As at the date of this report FDR data has only been available for a 12-month period. The ABS has been unable to perform time series analysis on this data due to survivorship bias. However, over time more valuable longitudinal data will be possible, giving an indication of exit and entry rates in the sector which will allow for further comparison with the broader business sector.

Enhancing data quality by capturing franchisees' ABN information via the FDR (without such information having to be made public) and implementing rigorous data quality control measures would improve the database available to the ABS and enable greater evidence-based policy development and assessments. This would also allow for the collection of survivorship information to assess the relative 'churn' or failure rate for franchised small businesses. ABN information could also be linked by the ABS to the Business Longitudinal Analysis Data Environment.

In addition to this, future use of some of the survey questions used in this review could be conducted on a regular basis, and over time help build a body of longitudinal data that could be used as part of the evidence base for comprehensive policy evaluations.

¹⁵ IBISWorld, *Motor Vehicle Dealers in Australia*, p 8.

¹⁶ IBISWorld, *Truck Dealers in Australia*, p 41.

Finally, an important metric for measuring the degree of dysfunction in franchisor-franchisee relationships is dispute rates, yet current levels of data collection are ad hoc, differ from one jurisdiction to another, and are often not publicly available. Without this information, it is difficult to gauge the true level of dispute and whether a need for greater regulatory intervention is justified. ASBFEO, the ACCC and state small business commissioners should be encouraged to collate and publish data about the number of franchising-related complaints and disputes – either as part of ASBFEO’s ongoing small business data publication program or through the ACCC reinstating its regular six-month publication of small business and franchising statistics.

Findings	
I.	The size of the franchise sector has not kept pace with the rate of growth in the broader business population.
II.	Current statistics about the demography of the franchise sector, and metrics by which success can be measured, need to be improved.
Recommendations	Implementation suggestions
1. The Australian Government should ensure the provision of more comprehensive, robust statistics about the franchising sector.	1A. The Commonwealth Treasury should drive a cohesive approach to data collection regarding the franchising sector. It should leverage the FDR and existing data collection and expertise within the ABS, ACCC, ASBFEO, state small business commissioners and other relevant government bodies.
	1B. Surveys conducted for this review should be repeated in the future to improve longitudinal data collection regarding the sector.

1.5 Regulation of franchising

The key piece of regulation for the franchise sector is the mandatory Franchising Code of Conduct (the Code).¹⁷ The Code is made by regulation under the *Competition and Consumer Act 2010* (Cth) (CCA).

The Code outlines the rights and obligations of the parties involved, with a particular focus on pre-entry disclosure and dispute resolution. The Code also prescribes various operational requirements and contains rules about the termination of franchise agreements.

In addition to the code, the general legislative frameworks that regulate corporate conduct also apply in the franchising sector. Key laws include the *Corporations Act 2001* (Cth), the CCA, the Australian Consumer Law (ACL), and the *Fair Work Act 2009* (Cth) (FWA).

Ensuring an appropriate regulatory framework to support franchise relationships is the responsibility of the Australian Government, which establishes the policy and legislative framework. Two federal entities have specific roles: the ACCC enforces the legal framework, whilst the ASBFEO provides access to dispute resolution in the sector.

State and territory frameworks can also contain elements relevant to the franchise sector. For example, state small business commissioners in most jurisdictions typically provide access to dispute resolution services, complementing the role of ASBFEO. State commissioners play a particularly

17 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth).

important role where a franchise dispute coincides with a retail leasing dispute. One state, South Australia, also has its own franchising legislation providing for dispute resolution in similar terms to the Code, although this has rarely been used.¹⁸

One existing industry also has its own regulations, which mirror (but do not entirely replicate) much of the Code – resellers of petroleum products, which are governed by another industry code under the CCA, the Oil Code of Conduct.¹⁹ However, the Oil Code is not part of the current review and as such is not discussed in detail in this report.

Over the last 10 years there have been significant regulatory developments across both general legal frameworks and the Code, resulting in an incremental trend towards increased regulation of the sector. A recent and significant development is the expansion of the unfair contract terms regime (UCT) contained in the ACL. Effective from 9 November 2023, UCT laws now cover a larger number of small business contracts, and the inclusion of UCTs in those contracts is unlawful and subject to penalties.²⁰ The new thresholds are likely to capture a large number of franchise agreements which were previously exempt, and have the potential to quite significantly improve the fairness of agreements entered into between franchisees and franchisors.²¹ These enhanced UCT laws complement other existing fair trading provisions in the ACL which may apply in a franchise agreement, such as the principles-based prohibitions relating to unconscionable conduct, misleading and deceptive conduct.

Globally, franchising regulations vary in scope and detail, with over fifty countries enacting some form of franchising legislation. General commercial, competition, or contract laws may apply in jurisdictions without specific franchising legislation.

Submissions from franchisors often characterise Australia’s franchising sector as one of the most stringently regulated, with an onerous regulatory burden. However, increasing regulation of franchising has been a global trend in recent decades, and Australia still has lower barriers to entry than many other jurisdictions with *ex ante* regulatory regimes.²²

1.6 History of regulation and review

Franchising regulation in Australia has been marked by an almost constant process of regulatory reform, review and change over the last thirty years.²³

The earliest attempt to regulate the sector was initially proposed in 1976 by the Trade Practices Act Review Committee, but it was not until 1993 that a voluntary Franchising Code of Practice was

18 *Fair Trading (Franchising Industry Dispute Resolution Code) Regulations 2015* (SA).

19 *Competition and Consumer (Industry Codes – Oil) Regulations 2017* (Cth).

20 *Competition and Consumer Act 2010* (Cth), schedule 2, part 2–3.

21 The expanded UCT laws apply to protect businesses that have 100 or fewer employees or make less than \$10 million in annual turnover. In New South Wales, new car dealership agreements are covered by UCT terms regardless of the number of employees or turnover of the business and do not have to be proved to be standard form contracts (see *Motor Dealers and Repairers Act 2013* (NSW), part 6).

22 DLA Piper, *Global Overview of Specific Franchise Statutes and Regulations*, Lexology website, 16 March 2023, accessed 20 November 2023; IBISWorld, *Franchising in Australia*, p 25.

23 For a more detailed history of the early years of Australian franchising, see M Schaper and J Buchan, ‘Franchising in Australia: A History’, *International Journal of Franchising Law*, 7 May 2014, 12(4): 3–23.

established.²⁴ Subsequent reviews of the voluntary code led to a finding that the sector was not adequately regulated. This led to the introduction of the first mandatory Franchising Code in 1998 under the then *Trade Practices Act 1974* (Cth).

The first mandatory Franchising Code 1998–2014

Substantial revisions of the first Franchising Code were made in 2000 and 2006. The Parliamentary Joint Committee on Corporations and Financial Services published a report in December 2008, titled *Opportunity not opportunism: improving conduct in Australian franchising*.²⁵ The Government's response included the formation of an expert panel in 2009 to scrutinise unconscionable conduct and various problematic behaviours within the franchising sector under the *Trade Practices Act 1974* (Cth). Subsequent amendments to the Code resulted in increased disclosure and addressed issues such as unilateral contract variation and the imposition of legal costs.²⁶

In light of persistent concerns, including advocacy at the state level, the Australian Government commissioned Mr Alan Wein to independently examine the Code in 2013. Key reforms emerging from the Wein review were the obligation to act in good faith and the inclusion of civil penalties in the Code. With the original Code due to sunset in April 2015, it was remade, and these suggested reforms were included.

The second mandatory Franchising Code 2015–2023

Following the remaking of the Code, work continued within government to better understand the dynamics of the automotive franchising sector. In December 2017, the ACCC published a market study into new car retailing, which led to a government commitment to introduce specific provisions into the Code related to automotive franchising.

Subsequent concerns about the conduct of large franchisors, such as the underpayment of employees within franchise systems, and the dynamics of franchisor-franchisee relationships more generally, led to the Parliamentary Joint Committee on Corporations and Financial Services conducting a year-long inquiry in 2018–19. The inquiry tabled its *Fairness in Franchising* report in March 2019, making 71 recommendations. The Government formed the Franchising Taskforce in response.

Early in 2020, General Motors Holden announced that it was terminating its network of Australian-based franchise agreements and withdrawing its brand from the Australian market. Automotive franchising specific provisions were then introduced into the Code with effect from July 2020. After extensive consultations the Government formally responded to the recommendations contained in the *Fairness in Franchising* report in August 2020.

24 See Trade Practices Act Review Committee, *Report to The Minister for Business and Consumer Affairs*, Australian Government, August 1976; Schaper and Buchan, 'Franchising in Australia: A History'.

25 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, Australian Government, December 2008.

26 See B Horrigan, D Lieberman, and R Steinwall, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*, report to the Hon Dr Craig Emerson MP, Australian Government, February 2010.

The fallout from General Motors Holden's early termination of its franchise network continued to be a matter of significant public interest and ultimately prompted the Senate to commence an inquiry into General Motors' decision. This report was published in March 2021.²⁷

With effect from July 2021, a large number of changes to the Code were made which implemented the *Fairness in Franchising* reforms and further government commitments to strengthen automotive franchising protections. Key reforms included the introduction of voluntary binding arbitration, strengthened disclosure including in relation to supplier rebates, and tightened restrictions on franchisors requiring capital expenditure.

Key automotive sector reforms included prohibiting automotive franchisors from offering new car dealership franchise agreements, unless those agreements contained provisions providing for compensation in cases of early termination and provided a reasonable opportunity for the new vehicle dealership to make a return on any capital investment required by the franchisor.

Funding was allocated in the 2021–22 Budget to establish the FDR and following further consultation, significantly increased penalties were introduced. The FDR was launched in 2022.

The current Code, containing these various amendments, is now scheduled to expire ('sunset') in April 2025, unless the current review recommends otherwise.

27 The Education and Employment References Committee, *Driving a fairer deal: Regulation of the relationship between car manufacturers and car dealers in Australia*, Australian Government, March 2021.

Chapter 2: About this review

The Terms of Reference (as shown on page 4) have required a comprehensive review process that meets the requirements relating to 4 separate scheduled reviews of the Code:

- A statutory review of Part 5 of the Code (relating to New Vehicle Dealership Agreements)
- A sunset review of the Code (noting it is due to sunset on 1 April 2025)
- A post implementation review of the 2021 amendments to Part 5 of the Code (relating to New Vehicle Dealership Agreements)
- A statutory review of the FDR (from 15 November 2023).

To address the review's terms of reference, a number of thematic areas were used to analyse stakeholder views, existing data sources, and to reflect the differing perspectives from which the regulatory framework must be effective in order to be fit for purpose. These were:

1. The scope and structure of the Code
2. Entering into a franchise agreement
3. During a franchise relationship
4. The end of a franchise relationship
5. Regulatory oversight and dispute resolution.

The review was informed by formal submissions, bilateral and roundtable stakeholder meetings, existing and new data collections, and examination of relevant research and academic papers, including previous reviews.

2.1 Submissions and consultation paper

A consultation paper was released on 22 August 2023 inviting the public to make written submissions. Stakeholders were also invited to provide feedback via phone, mail and email.

Over 1700 franchisor entities were invited to participate in the public consultation, with emails sent to all franchisors on the FDR alerting them to the review and consultation paper. Submissions were also invited through sector and other relevant stakeholder groups. Government bodies including ASBFEO, Treasury and the ACCC also promoted the review through their social media pages, websites, newsletters and other communications.

A total of 95 formal submissions were received. Table 4 contains a list of non-confidential submissions which are expected to be made available on the Treasury review website in due course.

Table 4: Submissions

1	Emeritus Professor Jenny Buchan	59	Australian Chamber of Commerce and Industry
3	Mr Paul Hadden	60	Australian Lottery & Newsagents Association
7	Speedy Autoglass	62	Craveable Brands
11	Mr Derek Sutherland	63	Queensland Small Business Commissioner
15	Mr Alan Wein	64	Business Council of Co-operatives and Mutuals
16	Mr Ken Rosebery	66	Adiba Fattah, PhD candidate, University of the Sunshine Coast
17	Mr Richard Kim	67	Australia Small Business and Family Enterprise Ombudsman
18	Anonymous franchisee	68	Law Council of Australia
22	Anonymous franchisor	69	Hilton
23	Anonymous multiple franchisees	70	Australia Post
24	Minerva Law	71	Australia Automotive Dealer Association
27	Mr Karim Girgis	74	Guzman y Gomez
28	Mr Sean Kreskay	76	Australian Banking Association
30	Anonymous franchisee	77	Post Office Agents Association Limited
31	Ms Lorraine Perkins	78	Newsagents Association of NSW and ACT
39	Dr Sudha Mani	79	Operation Redress
40	Australian Motor Dealer Council	81	Queensland Law Society
41	Motor Traders Association of Australia	82	Levitt Robinson
42	Australian Association of Franchisees	83	WA Small Business Development Corporation
43	V.S. George Lawyers	84	Australian Automotive Aftermarket Association
46	Kia Dealer Council	86	Anonymous franchisee
48	Franchise Council of Australia	89	Mr Derek Minus
50	HWL Ebsworth on behalf of JLR National Dealer and Representative Council Limited	90	Anonymous franchisor
56	NSW Small Business Commissioner	92	Australian Retailers Association
57	7-Eleven	93	Federal Chamber of Automotive Industries
58	Australian Competition and Consumer Commission	94	Franchise Advisory Centre

2.2 Stakeholder meetings

A wide range of stakeholders were invited to participate in meetings. Over 40 meetings and roundtables were held with organisations or individuals, including:

- Australian Association of Franchisees
- Australian Competition and Consumer Commission
- Australian Small Business and Family Enterprise Ombudsman
- Australian Automotive Dealers Association
- Franchise Council of Australia

- Federal Chamber of Automotive Industries
- Franchise Advisory Centre
- Franchise Relationships Institute
- Small Business Commissioners (NSW, Victoria, SA, Qld, WA)
- SME Business Law Committee
- Thrive Refugee Enterprises
- Victorian Small Business Commissioner.

Several of these organisations participated in more than one meeting.

The consultation process also included 13 roundtable meetings held between August to October 2023, which provided an opportunity for the review to hear directly from both franchisors and franchisees (see Table 5).

Table 5: Roundtables

Host	Date
Australian Automotive Dealers Association	12 September 2023
Australian Association of Franchisees	11 September 2023
ACCC Small Business and Franchising Consultative Committee	3 November 2023
Alternative dispute resolution practitioners	12 September 2023
Franchise Council of Australia	15 September 2023 23 October 2023
Federal Chamber of Automotive Industries	12 October 2023
Motor Traders Association of Australia	28 August 2023 23 October 2023
Small business commissioners (including ASBFEO)	11 September 2023 27 October 2023
Panel of franchise sector professionals (Emeritus Professor Jenny Buchan, Ms Alicia Hill, Mr Gavan Ord, Mr Derek Sutherland, Mr Alan Wein)	26 September 2023 30 October 2023

2.3 Other inputs

Given the lack of existing data to support analysis during the review, 3 new data sets were produced specifically for the review. Key findings are discussed in Chapter 1 and other relevant parts of this report. Complete data is included at Appendix B (Franchisee survey), Appendix C (FDR survey) and Appendix D (ABS report).

In addition, a number of existing data sources and general business literature and resources were drawn on to inform the findings and recommendations made in this report. Where appropriate, these have been included in the footnoted references to this report.

Chapter 3: Scope and structure of the Code

In evaluating any regulatory scheme, consideration should be given to the purpose of the laws and the scope of their application. Ensuring laws are ‘right sized’ is particularly important when regulating sectors with large numbers of small business participants.

This chapter of the report considers matters relating to:

- The purpose and effectiveness of the Code (including whether it should be remade prior to sunseting)
- Definitional issues relating to coverage (including exemptions from the Code)
- The scalability of obligations and protections in the Code
- The appropriateness and scope of industry specific protections in the Code
- Matters relating to drafting, legal principle and regulatory stability

3.1 Purpose and effectiveness of the Code

Existing approach

The Code states that its purpose is ‘to regulate the conduct of participants in franchising towards other participants in franchising’.²⁸ The Explanatory Statement for the Trade Practices (Industry Codes—Franchising) Regulations 1998 (the original mandatory 1998 Franchising Code) provided further insight into the purpose of the regulations. It stated that the Code aimed to protect all franchisees by establishing minimum standards of disclosure and conduct without endangering its vitality and growth, and to address the power imbalance between franchisors and franchisees. The Code was also intended to reduce the cost of resolving disputes in the sector, thereby reducing risk and generating growth by assuring a level of certainty for all participants.²⁹

These objectives should be considered in the context of the broader legislative framework within which the Code now exists. The purpose of the CCA is to enhance the welfare of Australians through the promotion of competition and fair trading, and by provision of consumer protection.³⁰ Part IVB of the CCA relates to industry codes and provides for them to be prescribed in regulations and to be declared mandatory or voluntary.³¹

When it was introduced in 1998, Part IVB aimed to ‘provide small business with dual advantages – the benefit of participation in the design of industry regulation addressing unfair conduct and meeting best practice, as well the security that mandated codes or provisions of codes may be directly enforced under the Trade Practices Act itself’.³² That is, industry codes were originally

28 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 2.

29 See Explanatory Statement, Trade Practices (Industry Codes—Franchising) Regulations Bill 1998.

30 *Competition and Consumer Act 2010* (Cth), section 1.

31 *Competition and Consumer Act 2010* (Cth), section 51AE.

32 Second reading speech, Trade Practices Amendment (Fair Trading) Bill 1997 (Cth).

considered as a flexible mechanism that adopted the ideals of self-regulation as distinct from the rigour of other more direct forms of regulatory oversight.

What we heard

Stakeholders tended to agree that the purpose and objectives of the Code need to be more clearly articulated. One stakeholder stated that ‘it is hard to imagine a less useful purpose statement’ when discussing the current purpose statement in Clause 2 of the Franchising Code.³³

The purposes of the Code expressed in the 1998 Explanatory Statement remain relevant, with most stakeholders agreeing the Code exists to address the power imbalance between parties and to raise standards of conduct. However, stakeholders disagreed on how effective the Code has been in achieving this. For example, the ACCC noted the purpose did not align with the protective nature of the Franchising Code.

The ACCC considers that the current purpose fails to recognise that the Code exists because franchisors enjoy a persistent superior bargaining position in relation to their franchisees and prospective franchisees. The substantive content of the Code makes it clear that the purpose of the Code is to attempt to protect franchisees and prospective franchisees.³⁴

Stakeholders submitted that the purpose of the regulatory framework was to create a set of minimum standards, and to also encourage best practice.

Legislation and prescribed codes of conduct provide the minimum standards for businesses in entering, operating and exiting of franchising arrangements. However, although industry codes may set a floor for behaviour, they should also encourage ‘best practice’ good behaviours that exceed the minimum standard that is set.³⁵

Some stakeholders argued the purpose of the Code should be to completely eliminate these power imbalances. Others argued that the purpose should be to ensure that there were, in effect, no disputes or unaddressed misconduct in the sector. Some stakeholders considered that the Code should prevent franchisors from profiting from franchise arrangements unless their franchisee has been able to earn a ‘wage’ from the business.

A fair day’s work for a fair day’s pay at the Award rate applicable to a fuel store manager, should be written into all Franchise Agreements as a priority payment – ahead of any split of gross revenue.³⁶

Consistent with the mixed views regarding purpose of the Code, there was disagreement among stakeholders on the Code’s fitness for purpose, or its effectiveness in achieving its purpose. At the

33 Australian Association of Franchisees (AAF), *Submission on behalf of the Australian Association of Franchisees*, AAF, p 2.

34 Australian Competition and Consumer Commission (ACCC), *ACCC submission*, ACCC, p 13.

35 Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Franchising Code Review Submission*, ASBFEO, p 4.

36 S Levitt, *Submission to Franchising Review Secretariat Unit, Small and Family Business Division, The Treasury, Commonwealth of Australia*, Levitt Robinson Solicitors, p 5.

highest level, franchisors and their representatives generally supported the view that the Code is fit for purpose and should be retained, whilst also identifying areas for improvement and simplification.

... the Code is fundamentally fit for purpose. The disclosure based framework mirrors franchise regulation around the world, and balances the expectations of responsible franchisor behaviour and franchisee due diligence and investment responsibility. It is also consistent with the frameworks that apply to investments in shares and securities.³⁷

Other stakeholders argued the Code was not achieving its purpose and suggested changes to address these concerns. Some even went so far as to submit that the Code was no longer fit for purpose and a new approach was needed.

AAF totally rejects any idea that the code is fit for any worthwhile purpose ... The regulatory framework for franchising needs a rethink from first principles. Whether an industry code is an adequate arrangement on its own is a serious question. Legislation, whether an extension of the Corporations Act or standalone, needs to be considered, potentially in tandem with a much-modified code.³⁸

The ACCC similarly expressed more fundamental concerns regarding the effectiveness of the Code.

After over 25 years of a prescribed Code, the ACCC considers that even an amended Code cannot address or prevent the persistent harms in the franchising sector.³⁹

The ACCC's views are considered further in Chapter 7.

Observations

Understanding the purpose of the Code is important when assessing whether it is 'fit for purpose'. Given stakeholders' mixed views about the Code's purpose, it is unsurprising that there are differing views of the Code's effectiveness.

The current purpose statement in the Code is too narrow to give all parties a realistic understanding of what the Code can – and cannot – achieve for them. A clearer articulation of the purpose statement will improve the ability to assess the efficiency and effectiveness of the Code's regulatory framework. From the perspective of regulators and advisors, this would help set expectations for sector participants and support non-regulatory interventions, such as developing guidance material.

Given the narrow purpose statement, it is necessary to consider the implied purposes of the Code and extrinsic materials, such as the Explanatory Statement for the original 1998 Franchising Code when evaluating its fitness for purpose.

The original Explanatory Statement articulated the purpose of the Code as improving the sector in key aspects, rather than completely fixing or resolving issues; the aim was to *raise* standards of conduct rather than to *ensure* high standards of conduct. It also aimed to *reduce* rather than *eliminate* risk, *reduce* costs of dispute resolution as opposed to ensuring there were no disputes, and

37 Franchise Council of Australia (FCA), *Strengthening the Franchising Code: Submission to the Review of the Franchising Code of Conduct*, FCA, p 13.

38 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 3.

39 ACCC, *ACCC submission*, p 9.

address power imbalance as opposed to eliminating that imbalance. This acknowledges that, even in a well-regulated sector, regulation cannot completely eliminate the risk of corporate misconduct and power imbalance.

Since the articulation of these particulars, there have been a number of reviews and amendments to the Code. Cumulatively, these changes have amplified the protective intent of the Code. It has evolved from a 'light touch' regulatory framework which provided guidance on minimum standards, to a more direct form of regulation that aims to establish norms of conduct and exposes sector participants to significant penalties for non-compliance. While it was originally envisaged the Code would be 'co-regulatory', stakeholders increasingly expect the regulator to be more active in overseeing the sector.

Compared to a hypothetical situation where there is no regulation, the current Code has effectively raised standards of conduct, reduced risk, addressed power imbalance and reduced the cost of dispute resolution. In combination with the provisions of the CCA and ACL, it also empowers the regulator to oversee compliance and pursue wrongdoing, consistent with the sector's expectation that the regulator can act to address problematic conduct. The Code is an important framework for improving outcomes for sector participants and, as such, is generally fit for purpose.

It is recommended that the Code be remade prior to sunseting in April 2025. The new Code should implement the recommendations outlined throughout this report. Government should also consider whether, in the long term, there may be more effective ways to regulate the sector, as discussed in Chapter 7.

Finally, even if the purpose of the Code is clarified, it is difficult to confidently evaluate the success of regulation without reliable data. During the review, it was evident that more data is needed to inform regulatory settings for the franchising sector. This is consistent with the findings in the *Fairness in Franchising* report.⁴⁰ Data gaps and a recommendation regarding data collection is discussed earlier in Chapter 1.

3.2 Definitional issues relating to coverage and exemptions

Existing approach

A central part of the Code is the manner in which it defines a franchise agreement. This is a critical factor in determining whether the Code applies to regulate a contract between two businesses.

Under the Code, a franchise agreement is a contract whereby one person (the franchisor) grants another person (the franchisee) the right to operate a business in Australia.⁴¹ The agreement spells out how goods or services are to be supplied under a specific system or marketing plan which is substantially determined, controlled, or suggested by the franchisor. The contract must also be associated with a particular trademark, advertising or a commercial symbol that is owned, used,

40 Parliamentary Joint Committee on Corporations and Financial Services, *Fairness in Franchising*, Australian Government, March 2019, p 63.

41 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 5.

licensed, or specified by the franchisor or its associate.⁴² The franchisee must make, or agree to make, certain types of payments to the franchisor or its associate, before starting or continuing the business.⁴³

Particular arrangements apply to participants in the motor vehicle industry. For example, the Code deems all motor vehicle dealerships as franchise agreements, regardless of whether or not all the above conditions are met, and since 1 July 2021 the Code explicitly includes motor vehicle dealerships which operate as the agent of an OEM (as opposed to the traditional model, in which dealers purchase new car stock from the franchisor and on-sell to consumers).

Exemptions from the Code ensure that it does not inadvertently capture sectors that have fundamentally different business models to franchising. For example, changes made to the Code in 2021 and 2022 clarified that it does not apply to co-operative or mutual entities.⁴⁴ This exclusion reflects the understanding that cooperatives, unlike franchises, are owned and controlled by their members. These members have voting rights based on membership rather than shareholding and as such do not exhibit the same inherent power imbalances and potential conflicts of interest that can exist in traditional franchising models.

The Code also does not apply if another mandatory industry code applies.⁴⁵ This exemption ensures that the Oil Code of Conduct does not apply in parallel to the Code, notwithstanding similarities between fuel retailing and other types of franchise arrangements.

The Code also limits some obligations in relation to master franchisors. A master franchisor arrangement occurs when a franchisor grants to a subfranchisor the right to either grant a further subfranchise or to participate in a subfranchise.⁴⁶ Master franchisors may also be exempt from having to register on the FDR.⁴⁷

Finally, the Code does not apply to a franchisee agreement if the prospective franchisee is an existing supplier of goods, and the franchise arrangement will provide no more than 20% of the franchisees' turnover.⁴⁸

What we heard

Stakeholders were generally positive about the scope of the Code's coverage. No widespread concerns were raised about the definition of a 'franchise agreement' in the Code.

Stakeholders reported that the 2021 amendment to the definition of new motor vehicle dealerships had effectively clarified that the agency sales model falls within the scope of the Code.

42 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 5

43 *Ibid*, schedule 1, clause 5

44 *Ibid*, section 3A.

45 *Ibid*, section 3.

46 *Ibid*, schedule 1, clause 4.

47 *Ibid*, schedule 1, clauses 7 and 12.

48 For details on this exemption, see *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 3.

It has been the long-held FCAI position that agency sales model in relation to new motor vehicle sales was already covered by the Code and the automotive specific provisions.⁴⁹

There were no reports that there had been adverse or unintended consequences as a result of this amendment. Stakeholders reported that the amendments had assisted market participants dealing with the entrance of agency models, by ensuring that the Code had appropriately captured those models and clarified the standards it imposes on those participants.

Bringing these service-oriented agreements under the Franchising Code's umbrella helps ensure a consistent and equitable regulatory framework across the automotive industry.⁵⁰

Stakeholders raised concerns about OEMs seeking to structure franchise agreements such that service and repair work was no longer conducted under motor vehicle dealership agreements. Stakeholders suggested that this is an attempt to limit the scope of an OEM's obligations toward franchisees and avoid the application of the Code altogether. It was submitted that service and repair work may not clearly meet the general definition of 'franchise agreement', even though this type of activity was traditionally covered by the Code since it was work performed under a motor vehicle dealership agreement. Stakeholders argued that clarity is needed on this issue, and that the definition of motor vehicle dealership should capture service and repair agreements.⁵¹

Very few stakeholders expressed views regarding the exemptions in the Code. The Business Council of Co-operatives and Mutuals reported that the amendments regarding cooperatives have been successful.

The BCCM believes the amendments accurately reflect the underlying policy intention: namely, that co-ops are a distinct model that, due to their democratic basis, do not exhibit the same power imbalances as investor-owned franchise networks and therefore should generally not be subject to the Code.⁵²

The AAF submitted that the definition and regulation of franchising should be recast on the basis that franchising is an investment and franchisees are investors.

A proper definition would lead to a different view of the regulatory requirements for the sector ... Franchisors contribute the initial intellectual property and the franchisees provide the investment to fund the enterprise and give value to the initial I.P. The implication of this thinking is that, in reality, franchising is a mechanism to raise the necessary funds to turn an idea into a commercial success.⁵³

49 Federal Chamber of Automotive Industries (FCAI), *Federal Chamber of Automotive Industries Submission to the Review of the Franchising Code of Conduct Consultation Paper*, FCAI, p 21

50 ASBFEO, *Franchising Code Review Submission*, p 14.

51 Motor Trades Association of Australia (MTAA), *MTAA 2023 Franchising Code Review Submission*, MTAA, p 21.

52 The Business Council of Co-operatives and Mutuals (BCCM), *Independent review of the Franchising Code of Conduct: Submission to the Treasury*, BCCM, p 3.

53 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 3–4.

Observations

Generally speaking, the Code applies effectively to the types of business relationships that are intended to fall within its scope. There are limited examples available of franchisors attempting to avoid being captured by the application of the Code.

The amendments to clarify that agency arrangements fall within the scope of a motor vehicle dealership have been well received by stakeholders and removed any ambiguity.

No adverse or unintended consequences were reported following amendments to more clearly exempt cooperatives, and no small businesses operating under this type of model came forward citing negative experiences or seeking the protection of the Code.

One matter that should be addressed is the segmentation of service and repair work by OEMs. This issue was considered by the Federal Court in the context of the recent Mercedes-Benz decision. Mercedes-Benz contended that its service and parts agreement with the dealers did not meet the definition of a franchise agreement. However, Justice Beach noted this contention was unsustainable.

Each is a “motor vehicle dealership agreement relating to a motor vehicle dealership that predominantly deals in new passenger vehicles or new light goods vehicles” and is thus a ‘new vehicle dealership agreement’ and thus a “franchise agreement”. To hold otherwise would permit a party to a franchise agreement to put certain aspects of its relationship outside the purview of the Franchising Code by hiving those aspects off into a separate agreement ... A purposive approach is required to be given to the relevant provisions of the Franchising Code ... ⁵⁴

Uncertainty in relation to service and repair work appears to be an unintended consequence of the 2020 and 2021 new vehicle dealership amendments. Given that this work is an integral part of motor vehicle dealerships and is characterised by the same relationship dynamics between dealers and OEMs as vehicle sales work, as noted by Justice Beach, it is appropriate for service and repair work to be conducted under the protections offered by the Code. Appropriate clarifying amendments should be made to the Code to avoid further doubt on this matter.

Finally, while franchising may share some characteristics with investment, there are fundamental differences between franchising and investment through shareholding or other forms of financial products. Franchise arrangements are exempt from the definition of managed investment schemes in the *Corporations Act 2001* (Cth), as franchisees have day-to-day control over the use of their contribution to generate a return or benefit.⁵⁵ Unlike a conventional shareholding, the franchise agreement represents a business-to-business transaction through which the parties work together for mutual commercial benefit and gain. Chapter 4 discusses the principle that franchise agreements should provide a reasonable opportunity for franchisees to use this day-to-day control to generate a return on investment.

54 *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth & Westpoint Star Mercedes-Benz & Ors v Mercedes-Benz Australia/Pacific Pty Ltd* (2023) FCA at 590 [3349].

55 *Corporations Act 2001*, sections 9 and 763B.

3.3 Industry-specific protections in the Code

Existing approach

In addition to the protections provided in the Code for all types of franchisees, there are additional protections set out in Part 5 of the Code for new motor vehicle dealerships. Part 5 first took effect on 1 June 2020. It was amended to include further protections with effect from 1 July 2021.

A new vehicle dealership agreement is defined as one that predominantly deals in new passenger vehicles or new light goods vehicles (or both). This excludes other types of motor vehicle dealerships, such as trucks, farm machinery and motorcycle franchises.

Additional protections for automotive franchisees require franchisees to be given a reasonable opportunity to make a return on their investments, and a requirement that OEMs must compensate their franchisees if that OEM prematurely terminates their franchise agreement for specified reasons. These reasons include the OEM deciding to change its distribution model in Australia, rationalise its network, or exit the Australian market. There are also additional notice and winding down requirements in relation to end of term arrangements.

As mentioned above, some franchise businesses also intersect with another prescribed code, the Oil Code of Conduct (Oil Code). The Oil Code is mandatory for those selling, supplying, or purchasing declared petroleum products.⁵⁶ The Oil Code and Franchising Code both regulate the relationship among sector participants with disclosure and dispute requirements.

The definition of a fuel reselling agreement in the Oil Code is similar to the definition of a franchise agreement.⁵⁷ The main distinguishing feature of the Oil Code is that it contains a price regulation mechanism. Examination of the Oil Code is outside the scope of the review's terms of reference and is not considered in detail in this report.

What we heard

Automotive franchising representatives were generally positive regarding the additional protections for new vehicle dealerships in the Code. The protections were not reported to have produced any major unintended consequences for franchisors and were welcomed by franchisees as having addressed concerns about conduct in the automotive franchising sector following a number of high-profile disputes.

VACC views the recent amendments to the Franchising Code to be a watershed moment for franchise new car dealers and thanks the Australian Government for introducing the automotive specific provisions via Part 5 and Part 6.⁵⁸

Stakeholders reported that there appeared to be some movement towards longer tenure for agreements and more meaningful discussions about return on investment and compensation.

⁵⁶ *Competition and Consumer (Industry Codes – Oil) Regulation 2017*.

⁵⁷ See *Competition and Consumer (Industry Codes – Oil) Regulation 2017*, clause 5.

⁵⁸ Victorian Automotive Chamber of Commerce (VACC), *VACC's response to The Treasury's Automotive Franchising: Discussion Paper*, VACC, p 9.

However, it was noted that the full impact of these amendments will not be known for some time, given they only apply prospectively to new franchise agreements.

Many stakeholders expressed support for the extension of the protections for new vehicle dealerships to other subsectors of the automotive industry, including motorcycle, farm machinery and truck dealerships. It was submitted that these businesses share similar characteristics to new vehicle dealerships and warrant the same additional protections.

The new protections in Part 5 and 6 must be made available to all commercial vehicle, motorcycle, farm, and industrial machinery franchised dealers.⁵⁹

In some instances, the exclusion of other types of motor vehicles was said to add complexity to business arrangements. For example, some franchisees may operate multiple franchise businesses selling both new vehicles and also trucks, motorcycles or farm machinery.

Other stakeholders, particularly franchisor representatives, disagreed with this assessment.

Many of the issues that caused the need for Part 5 of the Code to have been made ONLY affect the new motor car sector and potentially dealers in new motor-cycles [sic]. Publicly there does not appear to be examples where dealers of trucks, marine, buses and heavy machinery face the same changes to their models, terms of their agreement and non-renewal to warrant the imposition of Part 5 into their agreements.⁶⁰

Representatives of franchisees operating beyond the automotive sector supported the extension of the 2021 provisions for new vehicle dealerships to all franchisees.

AAF is somewhat bemused by the recent code amendments, primarily relating to asset amortisation, but solely for the automotive participants in the franchising sector. The unanswered question is why, when this baby step of reform was introduced, it did not apply to all franchising enterprises? Nearly all franchisees make capital investments, the same rules need to apply universally across the sector.⁶¹

In particular, several submissions argued that all franchise agreements should provide a reasonable opportunity for the franchisee to make a return on their investment. It was suggested that this would also enable a more meaningful discussion about franchise tenure terms with franchisors.

Franchisors operating outside of the automotive sector generally supported a 'light touch' approach to further changes to the Code. Some submissions noted that the protections available in Part 5 reflect existing best practice across the sector and their extension would minimise subsector carve outs.

The detail of the various protections in Part 5 is also discussed further in subsequent chapters of this report.

59 VACC, *VACC's response to The Treasury's Automotive Franchising*, p 11.

60 D Sutherland, *Submission to the Franchising Review*, p 11.

61 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 5.

Observations

The critical questions for this review are whether the automotive provisions of the Code are working as intended, without producing unintended consequences, and are the most effective option for addressing concerns within the automotive sector.

The intended benefits of Part 5 were to reduce the power imbalance and information asymmetry between OEMs and new vehicle dealerships. The provisions aimed to address unfair contracts in which OEMs required significant investment from franchisees, but in return only offered short term franchise agreements which did not represent a genuine opportunity to recoup the capital investment required. The provisions were intended to ensure that franchisees have a reasonable opportunity to earn a return on their investment.

The legislation seeks to achieve these objectives without diminishing outcomes for consumers and ensures franchisors can respond to market conditions.

The potential costs of Part 5 incurred by franchisors relate to the review of existing agreements and compliance with the new requirements. For the small number of sector participants who operate across multiple markets (for example, selling both new vehicles and motorbikes), there is a potential cost involved in managing different franchise agreements under different sets of rules.

Overall, Part 5 of the Code appears to have improved the operating environment for new vehicle dealers. The market has responded positively to the implementation of the changes. No sector participants suggested that Part 5 be removed from the Code; it now appears to be an accepted part of the regulatory framework. Noting that the provisions only apply prospectively, the long-term impact of Part 5 should continue to be monitored.

Distinctive characteristics of the new vehicle dealerships include the significant capital expenditure required to establish operations, significant power of multi-national OEMs, and the high turnover and value of the products sold (particularly in the context of requirements regarding product quality, safety, recalls and warranties). However, while this may be different to the typical franchise agreement, these characteristics are not unique to new car retailing. As the Fairness in Franchising report stated:

The committee considers that the franchising issues raised by dealers and their industry associations overlap with many of the issues identified by other sectors of the franchising industry. The committee is mindful of disadvantages that arise with the fragmentation of codes into multiple codes.⁶²

As such, there should be caution in further expanding sector-specific provisions in the Code. Given that Part 5 has only operated for a relatively short time, the review recommends improved data collection regarding Part 5. Any future review of the Code could use such data to assess the cost and benefits of these provisions, and whether there continues to be a clear rationale for sector-specific protections.

The merit of calls for strengthened protection in relation to return on investment (and compensation) are discussed in detail in other parts of this report, particularly Chapters 4 and 6.

62 Parliamentary Joint Committee on Corporations and Financial Services, *Fairness in Franchising*, p 233.

3.4 Matters relating to drafting, legal principle and evaluation

Existing approach

Legislative drafting, consistency of legal principle, effective transitional provisions, and structures for ongoing evaluation of the law are all key components of effective implementation of a regulatory framework.

The Code is made by regulation under the CCA. Regulations allow for flexibility since they are easier to amend than primary law. This can ensure responsiveness to sector needs and provides a greater role for the sector in the development and maintenance of the regulatory environment.⁶³ However, it can also result in frequent changes to the law, adding to compliance cost and creating the risk of deterring investment due to regulatory instability. All regulations sunset (expire) 10 years after they come into effect. If a regulation is still considered necessary, it must be remade.⁶⁴

What we heard

Stakeholders reported concerns about the frequency of amendments to the Code and the associated costs of responding to regulatory change.

... the Code has now been amended 10 times since 1998. This continual ongoing amendment has caused a large degree of regulatory fatigue and has at times imposed unnecessary compliance burden on OEMs.⁶⁵

In assessing recent amendments to the Code, some stakeholders believed that there had not been a sufficient implementation period to fully assess the impact of the amendments. Stakeholders noted that many franchise agreements typically run for five or more years, and as such many agreements have not yet reached the end of their term since certain recommendations from the *Fairness in Franchising* report were implemented with effect from July 2021.

Stakeholders from the automotive industry in particular raised concerns about the added costs of compliance for all parties to the franchise agreement. The impact was reported to be felt by both franchisors, who must prepare new disclosure documents and agreements that comply with any new provisions, and franchisees, who then need to seek advice on those changes.

Other stakeholders, while not calling for any further reviews, were mindful that the market is constantly evolving and suggested that a predictable schedule of reviews of the Code could provide an opportunity to maintain the relevance of the regulatory framework.

63 Explanatory Statement, Trade Practices (Industry Codes – Franchising) Regulations 1998 (Cth).

64 *Legislation Act 2001* (Cth), section 50.

65 FCAI, *Federal Chamber of Automotive Industries Submission to the Review of the Franchising Code of Conduct Consultation Paper*, p 6.

Some stakeholders argued that primary legislation should replace the Code because this would reduce the number of amendments, improve scrutiny of changes, and produce fewer unintended consequences.

Arguably the Franchising Code of Conduct has evolved ... and merits proper enactment as legislation where changes need to pass through both Houses of Parliament, and can be made in a more considered and less frequent manner.⁶⁶

One concern raised was the continuing existence of so-called ‘evergreen’ or perpetual agreements entered into many years ago, which still retain many disadvantageous clauses for franchisees that have since been prohibited for contemporary agreements.

Another concern raised by a number of stakeholders was the impact that frequent amendments to the Code had on its drafting. Many stakeholders called for a number of minor and technical amendments to be implemented. The amendments would not substantively change any of the existing obligations or alter the policy underlying the Code, but are focused on aligning drafting with current standard practices or in line with other pieces of legislation. As one submission noted:

If there is a genuine interest in making it more effective; then serious consideration needs to be given to fixing some of those drafting errors.⁶⁷

For example, the ACCC submitted that clarity could be provided in relation to the definition of a ‘disclosure document’ under the Code. The current Code defines ‘disclosure document’ in a way that presumes the disclosure document will be compliant with the requirements of the Code. This may lead to ambiguity about how non-compliant disclosure documents are to be treated.⁶⁸

Observations

The perceived instability of the regulatory framework was a concern shared by many stakeholders. The purpose of sunseting is to ensure that regulations are scrutinised at least once each 10 years, however the Code has been amended 8 times since it was re-made with effect from 2015. Given many changes only apply prospectively to new franchise agreements, there is a lag in the beneficial effect of each set of reforms. At the time of this review, less than half of the sector is estimated to be benefitting from protections introduced in 2021.⁶⁹

Such frequent change also appears to have impeded awareness of protections added to the Code; indeed, some stakeholders made submissions to the current review advocating for suggested reforms which had in fact already been incorporated into the Code in recent years.

The sector requires some respite from the constant process of review. Reviews of the Code should be conducted at five-year intervals and should involve a mid-term and general sunseting review prior to

⁶⁶ FCA, *Strengthening the Franchising Code*, p 11.

⁶⁷ D Sutherland, *Submission to the Franchising Review*, p 3.

⁶⁸ ACCC, *ACCC submission*, p 16.

⁶⁹ The average term of a franchise agreement is estimated to be five years; for 50% of franchise agreements to benefit from a round of amendments, at least 2.5 years needs to have elapsed since amendments were made. See K Miles, *Managing Franchise Agreements: Transfers and Renewals*, FranchiseED website, 7 February 2018, accessed 22 November 2023.

remaking the Code. Committing to a predictable review cycle would assure confidence and certainty to the franchise sector, whilst reducing compliance costs.

Frequent review has also led to increased complexity in Code provisions. This is a common problem in legal frameworks subject to frequent ‘tinkering’.⁷⁰ Inconsistency or ambiguity in the drafting of provisions can obscure the policy intent of the Code and add to uncertainty for the sector. It can also increase the compliance burden for sector participants.

If the Code is remade prior to sunset, the legislative drafting process will provide an opportunity to address such concerns. Modern drafting practices should be applied in remaking the Code and consideration should be given to clarity of expression to match the policy intent of the Code. Appropriate transitional arrangements should also be made to ensure that as many franchisees as possible benefit from reform, particularly in regard to franchise agreements without a specified term. A number of suggested technical amendments are shown in more detail in Appendix A.

Raising the regulatory framework for franchising to primary legislation would be a fundamental shift, requiring a substantial period of time and increasing uncertainty for the sector without any major gains over and above the protections that can exist within a fit-for-purpose Code. For this reason, it is not supported by the review.

⁷⁰ Office of Parliamentary Counsel (OPC), *Reducing complexity in legislation*, Australian Government, June 2016, p 13.

3.5 Findings and recommendations

Findings	
III.	The Code is generally fit for purpose.
IV.	There is significant misunderstanding, especially amongst franchisees, about what the Code is meant to achieve. The current articulation of the purpose of the Code in Clause 2 does not adequately explain to readers why the Code exists, what it seeks to achieve, and what it does not cover.
V.	Amendments made to the Code in 2022 to exempt cooperatives and mutual entities are effective and have not produced any unintended consequences.
VI.	Part 5 of the Code relating to new vehicle dealerships is operating as intended and not producing any unintended consequences.
VII.	The sector requires some respite from a constant process of review.
Recommendations	Implementation suggestions
2. The Code should be remade, largely in its current format.	2A. Retain the Code, subject to the suggestions for change set out in recommendations below. 2B. When remaking the Code, the technical and drafting issues raised in Appendix A should be considered.
3. A clear statement of purpose should be inserted into the Code.	3A. The Code should be amended to explicitly state why it exists and what it seeks to achieve. A clear articulation that the Code is intended to <i>improve standards of conduct and ensure access to information and dispute resolution</i> , rather than <i>eliminate all misconduct or risk</i> , would clarify the expectations of franchisees regarding the extent of protection intended.
4. Service and repair work conducted by motor vehicle dealerships should be explicitly captured by the Code.	4A. The definition of motor vehicle dealership in the Code should be amended to clarify that it includes all sales, service and repair work.
5. Reviews of the Code should be conducted in five yearly cycles in the future.	5A. To provide certainty to the sector, the timing of a mid-term review (that is, five years after the Code is remade noting it will sunset after 10 years) could be provided for in a statutory provision of the Code. 5B. The next review of the Code should consider whether Part 5 should be retained and, if so, whether it should be extended to other subsectors such as trucks, farm machinery and motorcycles.

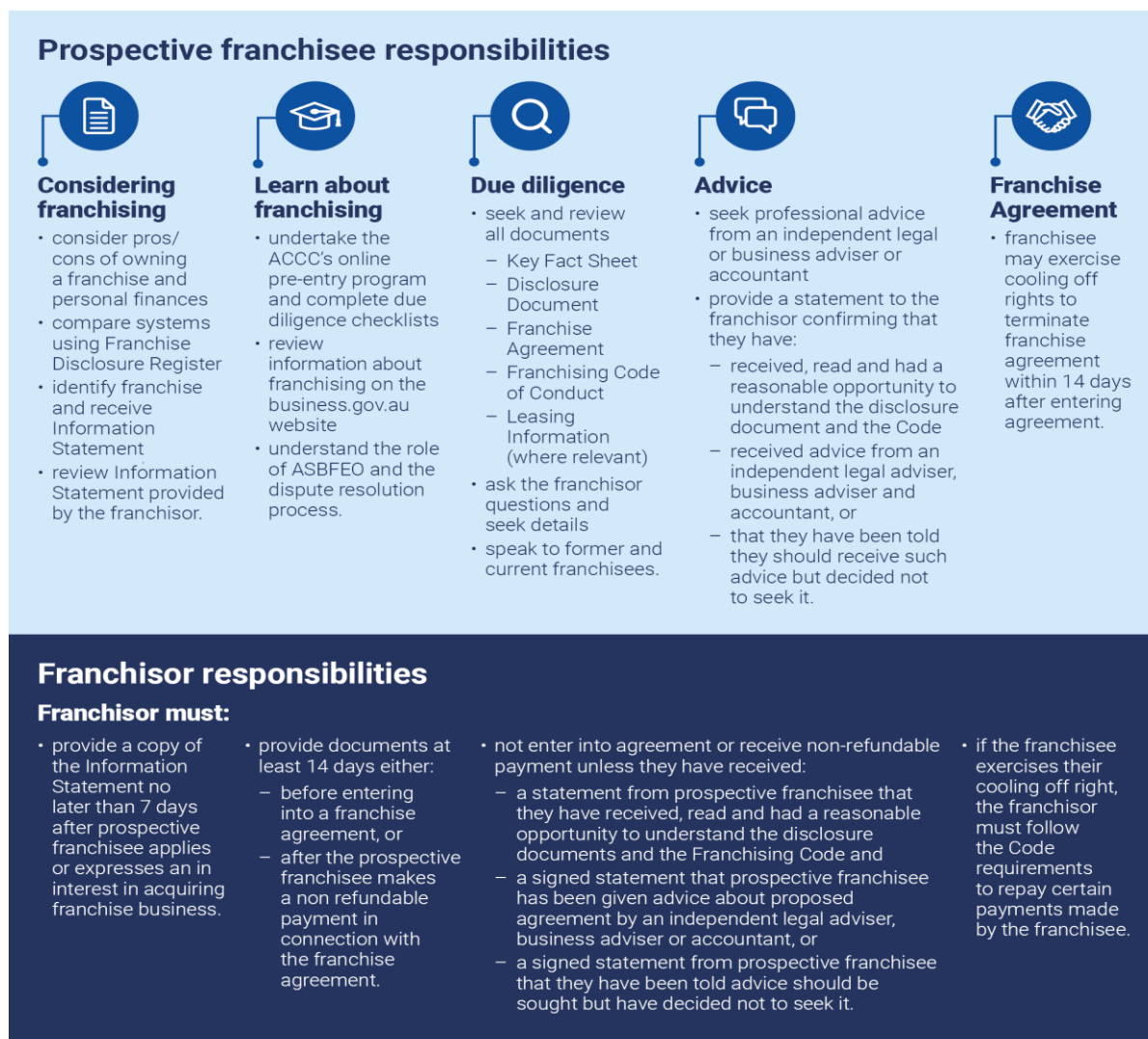
Chapter 4: Entering into a franchise agreement

Much of the current regulatory framework is based on the principle that 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. This chapter of the report considers matters relating to the entry of a prospective franchisee into a franchise agreement, including:

- The role and limits of disclosure
- Pre-entry education and advice
- Regulation of contractual terms
- The role of the Franchise Disclosure Register.

The requirements under the Code to provide information are complex. A relatively simple way to gain an overview of these is provided in Figure 1 below, which maps the journey of a typical franchisee upon entry into a franchise agreement.

Figure 1: Process for prospective franchisees who wish to enter into a franchise agreement



4.1 The role and limits of disclosure

Existing approach

The Code requires franchisors to provide franchisees with a range of information at least 14 days before they can enter into a franchise agreement. Information is provided through the disclosure document, which must follow a standard format as per Annexure 1 to the Code.

When the franchisor provides a copy of the disclosure document to a prospective franchisee, it must attach a range of other documents including a copy of the franchise agreement, the Code and leasing information where relevant.

In 2021 a new requirement was introduced to provide a Key Facts Sheet (KFS) with the disclosure document. The KFS is 'intended to draw particular attention to the most crucial information

contained in the disclosure document'.⁷¹ It requires franchisors to provide high-level information in a prescribed format, using a six-page template published on the ACCC's website.⁷² The template includes basic information about the franchise system, including costs the franchisee can expect to incur. It also highlights commonly misunderstood features of a franchise agreement which can subsequently become the causes of dispute, such as whether the franchisee is entitled to any compensation for goodwill in the business.

In 2022, the FDR was also established to provide information to prospective franchisees to compare franchise systems.⁷³ The FDR is discussed in detail later in this chapter.

What we heard

Stakeholders generally supported the need for pre-entry disclosure as a component of the franchising regulatory framework. However, this support was qualified in many cases by a concern that the existing disclosure rules have resulted in an overwhelming amount of information (sometimes in excess of 500 pages) being provided to franchisees.⁷⁴

Some stakeholders reported that it was difficult for franchisees to engage effectively with complex and lengthy disclosure materials.

The Disclosure Document has been drafted by lawyers yet the average franchisee cannot comprehend most of the questions.⁷⁵

While new franchisees should be supported with information to assist them to exercise due diligence, it may not be in the interests of either franchisees or franchisors to produce and maintain increasingly wide-ranging and complex documents. The depth of detail in disclosure documentation can impede good decision-making by prospective franchisees by obscuring relevant detail and making the task of considering that detail simply too hard.⁷⁶

QLS would welcome steps taken to reduce the level and duplication of disclosure that is required under the Code. In the experience of our members, the process has now become too complicated and the documentation, too extensive. The extent of documentation that a franchisee has to review can be overwhelming.⁷⁷

The Franchise Council of Australia reported feedback from its members that the complexity of documentation is treated like 'a prompt from Apple to read the T&Cs for the next upgrade in that people scroll to the end and then simply hit accept'.⁷⁸

71 *Explanatory Statement, Competition and Consumer (Industry Codes – Franchising) Amendment (Fairness in Franchising) Regulations 2021* (Cth), item 6.

72 See ACCC, *Key Facts Sheet*, ACCC website, November 2021, accessed 9 November 2023.

73 See Franchise Disclosure Register, *About the Franchise Disclosure Register*, Australian Government website, n.d., accessed 9 November 2023.

74 FCA, *Strengthening the Franchising Code*, p 15.

75 *Franchisee survey* [data set], October 2023, accessed 21 October 2023 (see Appendix B for more details).

76 ASBFEQ, *Franchising Code Review Submission*, p 5.

77 Queensland Law Society (QLS), *Submission to the Review of the Franchising Code of Conduct*, QLS, p 2.

78 FCA, *Strengthening the Franchising Code*, p 20.

Some stakeholders held the view that disclosure had a counter-productive effect – giving franchising the appearance of being highly regulated, and thereby creating a perception that it is low risk.

The franchisee survey conducted for this review asked franchisee respondents to assess the level of information they received as part of the pre-entry disclosure process. Only 18% of franchisees thought that the current disclosure requirements provided too little information overall; 38% of franchisees believed that the disclosure materials contained too much information, followed by 29% who thought it was the right amount of information and 15% who considered the wrong information was disclosed.

Some stakeholders commented that the cumulative complexity of disclosure materials is particularly difficult for franchisees from CALD backgrounds. Stakeholders reported that instead of analysing or seeking formal advice on the disclosure materials, prospective CALD franchisees may be deterred from seeking formal advice and instead rely on community leaders or trusted advisors to evaluate the offer. This may be a significant issue; some stakeholders estimated CALD representation among franchisees to be up to 60% (whereas they comprise 29.5% of the total Australian population, and 29.8% of self-employed persons).⁷⁹ It was suggested that such groups may be particularly drawn to franchising because '[n]ew immigrants find it difficult to obtain finance to invest in small businesses unless there is a strong third party, such as a franchisor, providing some form of collateral to their lender'.⁸⁰

In terms of identifying options to improve the disclosure regime and address these concerns, stakeholders tended to agree that the KFS had limited utility given it contains similar information to the information on the FDR. The KFS was generally considered to add to the complexity of disclosure materials and regulatory burden for franchisors, and lacked a clear rationale.

The Key Facts Sheet ... duplicates compliance obligations for franchisors, and in practice, is of minimal utility to prospective franchisees ... it is overwhelming in length and counterproductive, as it is so long and complex that prospective franchisees simply don't read it.⁸¹

Instead, some parties suggested that a short 'term sheet' containing the key commercial aspects of the agreement would be more useful to franchisees than repeating information available in the disclosure document and on the FDR.⁸²

This was supported by some franchisees who submitted that changes should be made to '[s]implify the disclosure and contract requirements, as it repeats itself over and over and makes it too hard to understand'.⁸³

79 Comparative data is drawn from the ABS (2022), *Australia's Population by Country of Birth*, ABS Website, accessed 3 November 2023. Note: the percentage of self-employed persons that are from a non-English speaking background is based on country of birth, specifically those not born in Australian, New Zealand, United Kingdom, North America, or Ireland.

80 S Levitt, *Submission to Franchising Review Secretariat Unit, Small and Family Business Division, The Treasury, Commonwealth of Australia*, p 2.

81 FCA, *Strengthening the Franchising Code*, p 19.

82 Ibid., p 20.

83 *Franchisee survey* [data set], October 2023, accessed 21 October 2023 (see Appendix B for more details).

There were some calls for further disclosure of the income received by franchisors from third party suppliers. Franchisees generally expressed dissatisfaction with the level of transparency around the income derived by franchisors from third party suppliers to franchisees. Franchisees reported that the 2021 changes to the disclosure of supplier rebates had resulted in some franchisors changing their business practice so that, instead of the third party directly supplying franchisees, the franchisor becomes the supplier.

Franchisors can and do currently skirt around rebate disclosure by becoming a wholesaler ... It was a recommendation of the previous Senate inquiry into Franchising to quantify in real currency, with real data the amount of rebates received by the Franchisor. Many Franchisors changed to a wholesale model of Supply after these changes to disclosure rules came in to affect. I doubt the intention of these changes to the code was to discourage disclosure, but this is the direct result of it.⁸⁴

While there were some limited calls to modify other disclosure requirements, no widespread concerns were raised with the substance of other disclosure requirements.

Observations

The original purpose of the disclosure document was to address information asymmetry between franchisors and prospective franchisees. Because the franchisor knows more about the franchised business than a prospective franchisee, they are in a better position to gauge the true value of a franchise opportunity. The intent of the disclosure document was to ensure the franchisee had access to critical information to help inform their decision about whether to proceed.

However, many aspects of the disclosure document now go beyond what is necessary to address information asymmetry and repeat information contained in the franchise agreement, or information that franchisees can independently discover. In effect, the disclosure document has evolved from being a tool to address information gaps, to being a comprehensive statement of all the matters a franchisee ought to know or consider before entering an agreement. The KFS and the FDR also now repeat much of the same information.

Stakeholder feedback on the limitations of disclosure reflects insights from behavioural economics, which has found that many individuals tend to exhibit particular behavioural biases. For prospective franchisees, these appear to include:

- **Optimism bias:** individuals tend to believe that they are less likely to experience a negative event than the average person. In a franchising context, this may mean franchisees enter into business with an overly optimistic view of how the business will likely operate. When expectations are not realised, this may lead to disputes with the franchisor. Given that an implied benefit of franchising is the support of the franchisor, some franchisees may be tempted to overlook warning signs on the basis that the franchisor will be able to support them in the event of problems with the business.
- **Information avoidance bias:** individuals often choose not to obtain knowledge that is freely available. Franchisees may look to avoid disappointment or may not want to challenge their beliefs about their situation (such as challenging the veracity of their own business acumen or financial position). Related to this is confirmation bias, whereby once a franchisee has decided

84 *Franchisee survey* [data set], October 2023, accessed 21 October 2023 (see Appendix B for more details).

that they want to purchase a franchise, they may only hear the advice that supports that intention.

- **Heuristics:** in the context of overwhelming amounts of information, individuals are likely to look for shortcuts or proxies to make decisions. In the context of a franchise opportunity, this may include relying on their ‘instinct’ or ‘gut’, or representations from the franchisor. In the absence of specific financial information, the franchisee may look to imperfect proxies to ascertain value – including the franchise fees themselves (equating price with quality).

In 2019, the Australian Securities and Investments Commission (ASIC) co-authored a paper titled *Disclosure: Why it shouldn't be the default*.⁸⁵ Informed by behavioural insights, it suggested that disclosure can backfire in unexpected ways. For example, there can be a moral hazard of franchisees being less cautious because the amount of paperwork and regulation they are presented with suggests that the franchise agreement is highly regulated and is a safe transaction.⁸⁶

As the *Fairness in Franchising* report noted:

[I]n franchising (just like banking and financial services), disclosure alone is an insufficient regulatory response to power imbalances and exploitative behaviour by powerful corporations.⁸⁷

This review does not recommend that the information in the disclosure document itself be shortened or removed. However, the government should consider ways to streamline the information made available to franchisees. One example could include retiring the KFS, given the evidence it lacks utility and mostly repeats information available on the FDR.

4.2 The scalability of pre-entry obligations and protections

Existing approach

The Code does not attempt to reduce compliance burden or scale regulatory protection commensurate with risk; it is a ‘one size fits all’ model. All franchisees are entitled to the same protections at the point of entry into a franchise agreement, regardless of the scale of their investment, the length of the franchise agreement, or the experience or sophistication of the franchisee. Similarly, all franchisors must comply with the same requirements regardless of whether they are large multi-national corporations or small franchisors with only one or two franchisees.

85 Australian Securities and Investments Commission (ASIC) and the Dutch Authority for Financial Markets (AFM), *Disclosure: Why it shouldn't be the default*, ASIC and AFM, October 2019.

86 For further information on the role of behavioural insights and how it can inform effective regulatory policy see <https://behaviouraleconomics.pmc.gov.au/>.

87 Parliamentary Joint Committee on Corporations and Financial Services, *Fairness in Franchising*, page xiv.

What we heard

Many stakeholders expressed the view that disclosure rules for some types of franchisees should be simplified.

The FCA recommends that the Code be amended to create exemptions for low investment franchise systems, sophisticated investors, existing franchisees and other categories where comprehensive disclosure is not relevant or necessary.⁸⁸

Smaller franchisors said the costs associated with updating disclosure documents were often burdensome and sometimes superfluous, since their existing franchisees did not need or seek continuously updated documents. Furthermore, due to the prohibitive cost of obtaining fresh legal and business advice relative to their capital outlay, franchisees often did not request the updated disclosure documents.

A number of stakeholders suggested that there should be scope to '[a]llow franchisors to make limited or reduced disclosures (such as utilising the KFS), in circumstances where the prospective franchisee is an existing franchisee.'⁸⁹ One example was existing franchisees seeking to buy into additional stores, for whom full disclosure was said to be unnecessary.

Although franchisees did not tend to focus on the regulatory burden associated with producing disclosure materials, there was some support for reducing the complexity associated with becoming a franchisee. In responding to the franchisee survey, one participant suggested that there is:

... [t]oo much paper work and red tape especially for something that cost less than a car. The [sic] amount of paperwork we had to go through to buy a \$15K mobile franchise was crazy.⁹⁰

Observations

There can be significant discrepancies among franchisees in terms of their resources, desire, and ability to conduct due diligence and receive professional advice before entering into a franchise agreement.

In some regulatory regimes there are exemptions where it is recognised that the potential for misconduct or opportunistic behaviour is significantly reduced because of the experience or sophistication of both parties. For example, under the *Corporations Act 2001* (Cth) there is a distinction between retail and sophisticated investors when it comes to capital raising requirements.

Given these limitations, and the significant cost and regulatory burden involved in preparing disclosure materials, it may be warranted to take a more risk-based approach to the Code's disclosure requirements. This might include limiting the circumstances where franchisors must provide full disclosure to franchisees, in particular for existing franchisees looking to enter into a new franchise agreement.

88 FCA, *Strengthening the Franchising Code*, page 21.

89 Anonymous franchisor (private and confidential submission), *Review of the Franchising Code of Conduct*.

90 *Franchisee survey* [data set], October 2023, accessed 21 October 2023 (see Appendix B for more details).

4.3 Pre-entry education and advice

Existing approach

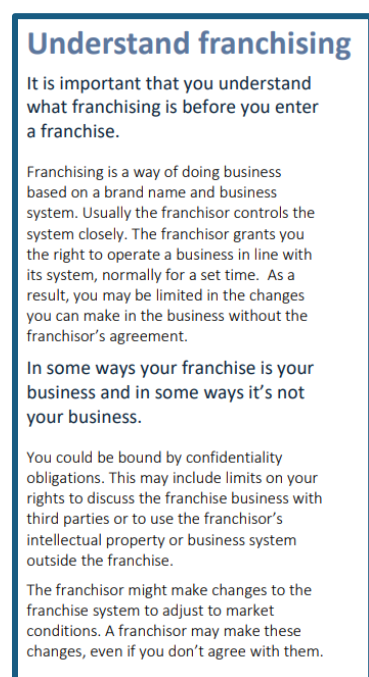
It is best practice for franchisees to receive professional advice and educate themselves about the general aspects of franchising, as well as the specific franchise opportunity they are considering, prior to entering into a franchise agreement. This is an important component of successful due diligence, and the Code contains two key mechanisms to support this.

The first is the requirement for franchisors to provide franchisees with the ‘Information Statement’ which can be found on the ACCC website. This must be provided at the earliest practical point after someone expresses interest in a franchise opportunity.⁹¹ The Information Statement is five pages long, containing important information for franchisees.

The second requirement is that, before a franchisor can enter into a franchise agreement, they must receive a written statement from the prospective franchisee which confirms that the franchisee has received, read and had a reasonable opportunity to understand the disclosure documents and the Code. The statement must also confirm that the franchisee has received advice from an independent legal advisor, business advisor and accountant *or* that they have been told they should receive such advice but decided not to seek it.⁹²

In addition to these minimum regulatory requirements, franchisors may impose their own requirements for on-boarding franchisees. Additional information is also made available on government and non-government websites to support the education of prospective franchisees (see Figure 3).

Figure 2: Excerpt from Information Statement



91 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 11.

92 *Ibid*, clause 10.

Figure 3: Key government resources for pre-entry information**Key government resources for pre-entry information**

www.business.gov.au – a whole-of-government website for the Australian business community, business.gov.au is a simple and convenient entry point for information, services and support for businesses succeed in Australia. It includes information for franchisors and franchisees, including a link to the FDR. During the 2022–23 financial year, the main franchising page of business.gov.au received about 7,700 unique visitors.⁹³

www.accc.gov.au – the ACCC’s franchising web pages include a range of information to assist prospective franchisees to conduct due diligence, including an interactive pre-entry education online course.

What we heard

Stakeholders generally considered that prospective franchisees’ engagement with available education materials and professional advice was poor. One reason offered was that professional advice is too expensive, particularly in the context of low investment franchise systems where the cost of seeking advice on the disclosure materials and franchise agreement may be disproportionate to the cost of buying into that franchise.

QLS encourages all parties to seek legal advice, but where this advice is time-consuming and complex, franchisees may be unable or unwilling to do so.⁹⁴

Some stakeholders also reported that the expense of seeking advice and the workload involved in reading multiple disclosure materials significantly constrained franchisees from seeking advice on different franchise opportunities. This effectively limited competition between franchisors to sign up franchisees.

Some stakeholders suggested that, given the importance of advice, the Code should mandate prospective franchisees to obtain advice.

Far too often have I seen parties arguing about matters that would have been addressed had the proper process of investigation and advice been obtained. The 2013 Franchise Code Review recommended that an independent legal advice certificate [be obtained] prior to entering into the franchise agreement ... This recommendation was not accepted on the basis that a Franchisee should not be required to incur greater costs. I suggest that the costs of not obtaining advice have costs [sic] both Franchisees and Franchisors millions of dollars of losses incurred in failed franchises, in addition to the emotional and psychological stresses of such failure.⁹⁵

In relation to professional advice, some stakeholders also raised concerns about the *quality* of advice. Stakeholders noted the importance of seeking professional advice from lawyers or accountants with

93 Note: the number of visits to the site in December 2022 was estimated because data for that period was not available.

94 QLS, *Submission to the Review of the Franchising Code of Conduct*, p 2.

95 A Wein, *Response to 2023 Franchise Code Review – Consultation Paper*, p 6.

franchising expertise. The Queensland Law Society suggested the possibility of improved professional recognition of franchising expertise among the legal community.

QLS supports information being made available to a franchisee stipulating that it should obtain legal advice, but we do not endorse this being mandated. A statutory requirement to obtain legal advice can create unnecessary costs and other burdens for the solicitor and their client. The focus can shift to complying with the requirement, rather than providing the client with the information they need ... Parties to commercial agreements are strongly encouraged to obtain legal advice before and during the transaction. This advice could be obtained on an as needed basis from qualified legal practitioners or, as part of an ongoing retainer with a law firm.⁹⁶

The franchisee survey sought information from respondents about whether they received independent professional advice prior to entry into franchise agreements. It found that more than 68% of respondents did so. This is an encouraging figure.

Some stakeholders considered that educational materials added to the ‘overwhelming’ amount of information franchisees receive at the point of entry into a franchise system.

Some stakeholders also suggested that online resources are not always the most effective way of disseminating information, given the different learning styles that prospective franchisees may have. The provision of in-person, or face-to-face, education was suggested.⁹⁷ It was also suggested by some that the ACCC’s low profile promotion and advertisement of its resources limited the effectiveness of pre-entry education.

The franchisee survey also asked franchisees to rate their knowledge of the Code. The average franchisee rated their knowledge of the Code as 6.3/10.

Some stakeholders also highlighted that the need for education was not limited to franchisees. Given the large number of franchisors that are themselves relatively unsophisticated small businesses, stakeholders suggested more focus should be given to educating and upskilling franchisors.

Commercial providers such as myself are the sole providers of education to start-up franchisors, and these vary in quality and consistency. [For example], [m]y Introduction to Franchising is conducted 4 times a year regardless of group size, whereas other providers will conduct only annual events, or set even[t] dates only when they have enough bookings – and often these events are loss-leaders for franchise consultancies seeking new clients who aspire to franchise their businesses.⁹⁸

Stakeholders reported that some poor conduct by franchisors may be due to a lack of knowledge and education, rather than bad faith or opportunism. Poor conduct could arise from insufficient understanding of obligations and of best practice approaches.

96 QLS, *Submission to the Review of the Franchising Code of Conduct*, p 5.

97 Law Council of Australia, *Review of the Franchising Code of Conduct*, Law Council of Australia, p 7.

98 J Gerkhe, *Submission to the Review of the Franchising Code*, Franchise Advisory Centre, p 5.

Observations

The uptake of pre-entry education and legal, accounting and business advice by prospective franchisees is important and should be encouraged. Government bodies, industry associations and advisory firms all have an important role in designing and promoting accessible forms of education and advice to support effective due diligence. Such mechanisms support competition by improving a prospective franchisees' ability to effectively value franchise opportunities.

However, as with disclosure, insights from behavioural economics support the general view from stakeholders that it is risky to over-rely on education and advice alone to address poor franchisor behaviour and the risk of individuals joining unsuitable or unviable franchises. As with disclosure, behavioural tendencies (for example, information avoidance and optimism bias) limit the effectiveness of pre-entry education and advice.

While it has been suggested that pre-entry advice could be made mandatory, there are challenges in doing so. As noted, around two-thirds of franchisees already report receiving advice prior to entering franchising.

Chapter 7 further discusses how the ACCC as the regulator supports providing education and advice.

4.4 Regulation of contractual terms and prohibitions on entering franchise agreements

Existing approach

The Code prohibits franchisors from including certain provisions in their franchise agreements. Examples of prohibited provisions include any requirement for franchisees to pay the franchisors' legal costs and any general release of liability of the franchisor in relation to representations.

Franchise agreements must also include a complaint handling procedure which provides for internal dispute resolution and mediation, consistent with Part 4 of the Code.⁹⁹

New vehicle dealership agreements must also have additional protections. Firstly, a franchisor must not enter a franchise agreement unless the agreement provides the franchisee with a reasonable opportunity to make a return on investment during the term of the agreement. This also includes any investment required by the franchisor as part of entering into, or under, the agreement. Secondly, a franchisor must not enter into a franchise agreement unless the agreement provides for the franchisee to be compensated if the franchisor prematurely terminates the franchise agreement should that franchisor withdraw from the Australian market, rationalise its network, or change its distribution models in Australia.

As noted in Chapter 1, the UCT regime has also recently been modified and will likely capture a larger number of franchise agreements in future.

99 See *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 34.

What we heard

No major concerns were raised about the current provisions of the Code which directly regulate the terms of franchise agreements.

Many stakeholders commented that while it was too early to assess the impact of the new automotive franchising requirements, they appear to be workable at the point of entry into new franchise agreements. Automotive franchisors did not report any major adverse or unintended consequences as a result of the 2021 amendments which introduced clauses 46A and 46B into the Code. The provisions were reported to have provoked positive, meaningful discussions with franchisees regarding the term and investment required from them. Some franchisors reported voluntarily extending the protections in 46B to their dealer network before they were being legally required to do so, demonstrating 'how strong partnership-oriented brands can operate'.¹⁰⁰

Automotive franchisees also reported that the 2021 changes had been positive from their perspective. However, they were concerned about the limitations of clauses 46A and 46B and sought to further extend those protections so that franchise contracts must provide for security of tenure and compensation in the event of non-renewal (as opposed to just early termination in certain circumstances). Issues relating to end of term and non-renewal are discussed further in Chapter 6.

As was noted in Chapter 3, franchisee representatives argued that the additional contract regulation that applies to new vehicle dealerships under clauses 46A and 46B of the Code should apply to all franchisees.¹⁰¹

Franchisees believe they are buying a business for the long term. They leave their jobs redirect their careers mortgage [sic] their houses based on this belief. Their risk is enormous.¹⁰²

This was supported by many franchisees, who gave anecdotal evidence that the term of their franchise agreement, the lack of entitlement to goodwill and franchisors' ability to unilaterally terminate or change the franchise arrangement deprived them of the opportunity to make a reasonable return on the investment made when entering the franchise agreement. This was particularly pertinent given the submissions from some franchisee stakeholders contending that franchising is a form of investment like shareholding and as such franchisees should be afforded rights akin to shareholders.

Automotive franchisees and their representatives also argued for UCT regulations to be replicated in the Code, on the basis that many automotive franchisees risked falling outside the scope of protection because they had more than 100 employees or a turnover greater than \$10 million.

Observations

Direct regulation of contracts and contractual terms is an area of the Code which has grown in importance as the limits of disclosure have been realised. Competitive markets are generally characterised by transparent valuations, and informed consumers (in this case, prospective

100 Anonymous franchisee (private and confidential submission), *Review of the Franchising Code of Conduct*.

101 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 5.

102 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 7.

franchisees). As markets become more competitive and information is more readily available, sellers are less able to inflate the price of their goods or services artificially and arbitrarily. By preventing franchisors from entering a franchise agreement unless it provides the franchisee a reasonable opportunity to make a return on investment, clause 46B of the Code attempts to rectify the problem of franchisors offering uncompetitive terms to franchisees. Although franchisees can notionally reject an agreement offering problematic terms, substantial sunk and switching costs act as barriers impeding prospective franchisee mobility between franchise systems.

The existing requirement for a new motor vehicle franchise agreement to provide a 'reasonable opportunity to make a return on any investment' is particularly relevant in the context of the limited term nature of franchising; the average franchise agreement has a relatively short term and does not usually allow franchisees to accumulate a capital return through the accumulation of goodwill.¹⁰³ Franchise terms may also be considered 'unfair' within the meaning of the UCT regime under the ACL if the term bears no reasonable relationship to the value of the investment required.

For these reasons, government should consider extending the requirements under clause 46B to the broader franchising sector. Such requirements are consistent with what a competitive market would require. There should be minimal regulatory impact associated with extending the protections under clause 46B to all franchisees, with the exception of transitional costs for franchisors to understand the nature and extent of the obligation. Such an extension would also assist with clarifying the reasonable expectations of franchisees that they have the opportunity to profit from the deal. It is apparent that many franchisees under the current framework expect to be able to extract goodwill to which they are not legally entitled, which may cause them to make incorrect assessments of value at the point of entry into franchise agreements. It follows that if a franchise agreement provides a reasonable opportunity to make a return on investment, then a franchisee should be compensated if that opportunity is cut short by the franchisor. Any extension of the requirement for a franchisee to be afforded a reasonable opportunity to make a return on investment should therefore include an extension of the related compensation requirements for early termination, set out in clause 46A.

The possible extension of clauses 46A and 46B to all franchise agreement was indirectly supported by several franchisee submissions, which argued that franchising is a form of capital raising by franchisors, and that franchisees should be treated like shareholders or other types of investors. While franchisees' capacity to influence and control the day-to-day success of the business makes them fundamentally different to other types of investors, it is important that a franchise agreement provides an opportunity (primarily through a sufficient term) for them to use this control and influence over the business to extract a return on investment.

Further time will be needed to assess whether the current provisions should be extended in substance as distinct from scope. It will take time for the full impact of the new provisions of Part 5 and expanded UCT laws to be known. UCT laws in particular may be expected to have a significant and positive impact on the fairness of franchise agreements, given sufficient time for industry to adapt to these new requirements.

103 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 7; MTAA, *MTAA 2023 Franchising Code Review Submission*, p 8.

4.5 The Franchise Disclosure Register

Existing approach

Since 15 November 2022, franchisors have been required to maintain a presence on the FDR. The purpose of the FDR is to assist prospective franchisees to compare different franchise opportunities. This was considered necessary because the confidential nature of disclosure materials makes comparison difficult for many prospective franchisees. Making high level information available on the FDR also addresses the inability of franchisees to access key information early and before they have formed a relationship with a prospective franchisor or become psychologically committed to proceeding with a particular franchise opportunity. The typical content of an FDR entry is shown in Figure 4 below.

The FDR is available at www.franchisedisclosure.gov.au and is administered by the Secretary of Treasury, who has delegated his functions to Senior Executive Service officers within Treasury. Enforcement of obligations relating to the FDR is a matter for the ACCC.

Figure 4: Partial extract from franchisor profile on the FDR

Franchisor Details	
Franchisor Name	Australian Postal Corporation
Franchisor Trading Name	Australia Post
Australian Business Number	28864970579
Address of the franchisor's registered office	111 Bourke Street, Melbourne Victoria 3000
Address of the franchisor's principal place of business	111 Bourke Street, Melbourne Victoria 3000
Industry Division	OTHER SERVICES
Industry Subdivision	Personal and Other Services
Description of the kind of business operated under the franchise	Australia Post operates a network of corporately owned and Licensed Post Office outlets to provide sales and distribution channels for Australia Post's products and services. All Licensed Post Offices are required to offer a basic range of Australia Post products and services, including postage stamps and prepaid postage products, money orders, banking services, bill payment services for third party agency principals and mail acceptance and processing as specified in the Licensed Post Office Agreement. Depending on customer demand, Australia Post may also require a Licensed Post Office franchise to offer a range of other Australia Post products and services such as post office boxes, philatelic items, POSTpak products and non-postal stationery items such as greeting cards, copy paper and telephone products.

In addition to the information required to be included on the FDR by the Code itself, the Secretary of Treasury can prescribe additional information from the disclosure document that must be included on the FDR. A determination of this kind is in place which requires the disclosure of additional information similar to that set out in the KFS.¹⁰⁴

The FDR also includes provision for franchisors to *voluntarily* include copies of their disclosure document, standard form franchise agreement, and KFS on the FDR. If these documents are included, personal information or information relating to individual franchisees is redacted from the documents. Most franchisors have chosen not to voluntarily upload these documents to the FDR.

¹⁰⁴ *Competition and Consumer (Industry Codes—Franchising) (Additional Information Required by the Secretary) Determination 2022* (Cth).

Treasury advised the review that for the period 1 July 2023 to 14 November 2023 there were over 3,979 unique visitors to the FDR search page, and that in total they made 22,000 visits. If this figure is annualised, it represents around 10,587 unique visitors and 58,394 total visits to the FDR in the first year.

Terms of use and other guidance available on the FDR website specify that the government does not endorse or check information provided by franchisors prior to inclusion on the Register. The FDR website directs franchisees to a number of other resources to assist them in conducting due diligence, such as the Information Statement and ACCC's online material. It also directs complaints and disputes about franchisors to the ACCC and ASBFEO.

Information about the FDR is also now included in the Information Statement which must be provided to all franchisees, and on websites frequented by prospective franchisees, including the ACCC website and business.gov.au.

What we heard

From 15 to 26 November a dedicated survey was undertaken to solicit views from users of the FDR based on its first full year of operation. The survey received 163 responses, which supplemented views provided in written submissions, stakeholder meetings and roundtable sessions.

The survey was primarily completed by franchisors and their advisors. Limited responses were received from franchisees, with no responses at all received from prospective franchisees notwithstanding that these are the intended audience for the FDR.

Overall, many franchisors considered the quantum of information they were required to include on the FDR was the right amount (42%), slightly more than a sizeable group which felt that it required too much information (38%).

As noted above, most franchisor respondents noted that they had chosen not to upload copies of their disclosure document, KFS, or franchise agreement to the FDR. The main reason given for not voluntarily doing so was confidentiality concerns (71%).

Although there were a limited number of franchisees that responded to the FDR survey, several of these reported that they perceived the information on the FDR to have been approved by government.

Submissions from franchisee representatives also reported reservations about the FDR.

The failure of the register is primarily that potential franchisees interpret the information on it, as having been vetted and endorsed by government. There is also a key failing in that the most important document, the standard form agreement is not included. Finally, as there is no licencing [sic] regime, participation is effectively, optional. Even where franchisors submit information, required documents are missing. There appear to be no arrangements for enforcing disclosure compliance[.] AAF supports a disclosure regime, but only as part of a comprehensive overhaul of the regulatory framework for the sector.¹⁰⁵

Franchisor representatives submitted that, given the regulatory costs and burdens they have incurred in complying with the initial establishment of the FDR, it should not undergo further change. They were also concerned about poor awareness of the FDR.

¹⁰⁵ AAF, *Submission on behalf of the Australian Association of Franchisees*, p 6.

It is invisible to prospective franchisees, as no resources have been committed to promotion.¹⁰⁶

Franchisor views that the FDR was of limited value to franchisees, and therefore imposed unwarranted burden on franchisors, were also evident in responses to the FDR survey.

I was an advocate for a register but I haven't spoken to one potential franchisee who knew it existed or what its main purpose. The Government spent a lot of money creating something that has zero benefit and is just another burden on small franchisors, especially in the services marketplace.¹⁰⁷

Some franchisors also expressed frustration with the usability of the FDR interface to meet the code obligations. While around half of franchisor respondents considered the FDR 'easier to use' or 'about the same' as other government registration processes, the requirement to use a Digital Identity was a particular concern.

The login requirements are utterly ridiculous. The UX is terrible. The myGov ID requirement is onerous.¹⁰⁸

However, there were indications that the usability concerns may be transitional in nature; phone and email enquiries from franchisors seeking support to meet their registration requirements declined from the 2022 to 2023 annual registration deadline.¹⁰⁹ Indeed, the majority of enquiries actually related to the use of Digital Identity rather than the FDR interface or legal obligations in the Code.

Respondents expressed concern that the lack of compliance and enforcement activity, or guidance on how to populate the FDR, had led to inconsistent approaches across the sector, limiting the usefulness of the FDR as a comparative tool.

The register is a good step in the right direction, however, there is no consistency ... There is no education and no enforcement, this leads to an un-level playing field where the franchisors doing the right thing are being punished because prospective franchisees are comparing the negative parts of their business against others who are non-compliant and do not share the correct information, making it look like they are a better investment. The Treasury and ACCC need to have an enforcement arm to protect prospective franchisees.¹¹⁰

The ACCC suggested that the FDR could be leveraged to create tighter regulatory controls on the sector by becoming a de facto licensing regime. This idea was also raised by other stakeholders.

The Disclosure Register could also be used as a form of control over [sic] non-compliant franchisors, such that any franchisor who does not meet the criteria to register, or who is suspended or removed from the Register is effectively barred from

106 FCA, *Strengthening the Franchising Code* p 19.

107 *Franchise Disclosure Register survey* [data set], 2023, accessed 28 November 2023, response number 36.

108 *Franchise Disclosure Register survey* [data set], 2023, accessed 28 November 2023, response number 30.

109 Treasury indicated to the review that inbound calls relating to the FDR declined from 51 in October 2022 to only 5 in October 2023. Inbound email enquiries also dropped from 34 to 19 for the month of October from 2022 to 2023.

110 *Franchise Disclosure Register survey* [data set], 2023, accessed 28 November 2023, response number 134.

granting further franchises (aside from resales of existing businesses on a franchisee to franchisee basis (versus franchisors on-selling company-owned outlets)).¹¹¹

Observations

The policy intent of the FDR is to increase transparency about the operation and structure of franchise systems, before prospective franchisees enter into franchise agreements.¹¹² The FDR also allows franchisees to start their due diligence earlier by conducting early research on franchise systems they may be interested in, without having to sign non-disclosure and other paperwork that may be required by a franchisor. It also allows professional advisors, industry bodies, media and academic researchers to be better informed about the operations of the sector.

Whilst some stakeholders saw limited utility in the FDR, there was nonetheless widespread support for it to remain a part of the regulatory environment. The FDR is still relatively new and is potentially capable of evolving over time into a powerful information tool, as well as a source of sector data and statistics.

The large number of profiles on the FDR is an indication of widespread compliance across the franchise sector. As noted above, ABS analysis of FDR data indicates there are around 1,144 franchise systems operating in Australia. This is consistent with industry and other sources' estimates of the size of the franchisor population in Australia. While some stakeholders were concerned about non-compliance with the requirement to register, this does not appear to be widespread.

Separately to the failure to register, some franchisors have provided low-quality information on the FDR with significant differences in the way franchisors have approached compliance. Hence, one issue which needs further clarification is compliance with the listing requirements. Treasury has no formal role in relation to enforcement and compliance with the requirements under Part 5A and is limited in its ability to address inconsistent or problematic approaches to compliance. This is the responsibility of the ACCC. Operation and administration of the FDR would therefore sit more appropriately with the regulator, given its broader responsibilities in relation to the Code.

Due to the low response rate from franchisees and their advisors in the FDR survey, it is difficult to draw firm conclusions about whether it is achieving its intended purpose of allowing prospective franchisees to compare information about franchisors. The FDR has only been operational for just over a year as at the date of this report. While it can be expected that awareness of the FDR will increase over time, further effort to promote the visibility and usage of the FDR to prospective franchisees would be highly desirable.

The FDR platform could also be leveraged to improve awareness and uptake of other positive developments including the introduction of voluntary binding arbitration facilitated by ASBFEO. Improved uptake of arbitration may be achieved by requiring franchisor profiles to contain information about whether a franchise agreement includes provision for arbitration of disputes.¹¹³ Given the importance of information about litigation and adverse actions by regulators, it would also be beneficial to highlight this information on the FDR for franchisees.

¹¹¹ J Gehrke, *2023 Franchising Code of Conduct Review*, p 3.

¹¹² *Explanatory Statement, Competition and Consumer (Industry Codes—Franchising) Amendment (Franchise Disclosure Register) Regulations 2022* (Cth).

¹¹³ Such information is already required to be included in disclosure documents – see *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), Annexure 1, item 17A.

The potential for the FDR to be transformed into a tool for regulating participation in the sector is discussed further in Chapter 7.

4.6 Findings and recommendations

Findings	
VIII.	The Code requirements relating to disclosure are comprehensive. They can sometimes be burdensome for franchisors to comply with, and burdensome for franchisees to comprehend and act on. Any further attempt to address concerns by mandating greater disclosure is likely to be counterproductive.
IX.	Certain disclosure and cooling off obligations in the Code create unnecessary regulatory burden when applied to the renewal of an existing franchise relationship.
X.	It is impractical to mandate compulsory pre-entry education and advice, however enhancements to education and advice by government would be beneficial.
XI.	All franchise agreements ought to provide a reasonable opportunity to make a return on investment (including provision for compensation in the event of early termination).
XII.	The FDR is a valuable addition to the regulatory landscape, but awareness and utilisation of the Register is low and greater enforcement of the listing requirements is likely to be needed.
Recommendations	Implementation suggestions
6.	Simplify and consolidate the pre-entry information given to prospective franchisees.
7.	Franchisor obligations under the Code in relation to existing franchisees should be simplified.
8.	The existing requirement that new vehicle dealership agreements must provide a reasonable opportunity to make a return on investment should be extended to all franchise agreements.
9.	The existing requirement that new vehicle dealership agreements must include provisions for compensation for franchisees in the event of early termination should be extended to all franchise agreements.
10.	Enhance the public visibility and usage of the Franchise Disclosure Register.
11.	Additional information should be included on the FDR relating to dispute resolution and adverse actions brought by enforcement agencies.
	6A. Merge the disclosure document and key facts sheet.
	7A. Existing franchisees entering into a new franchise agreement (or renewing or extending an existing agreement) should be able to opt out of disclosure and cooling off requirements designed to protect new franchisees.
	8A. Amend Clause 46B of the Code to apply to all franchise agreements, not just new vehicle dealership agreements.
	9A. Amend Clause 46A of the Code to apply to all franchise agreements, not just new vehicle dealership agreements.
	10A. More actively promote the FDR's existence and usage through education material prepared by business.gov.au, the ACCC, ASBFEO and state SBCs.
	10B. Responsibility for the administration of the FDR and its website should sit with the ACCC.
	10C. If a FranchiseSmart website model is adopted, incorporate the FDR into FranchiseSmart.
	11A. The FDR should state whether or not a franchise system offers binding voluntary arbitration.
	11B. Consideration should be given to including information on the FDR about any sanctions or court action taken by the ACCC, ASIC, FWO or ATO against a franchise system in the last five years.

Chapter 5: During a franchise relationship

Through the course of the franchise relationship there are obligations that aim to cultivate effective business practices between the parties on an ongoing basis. While not every situation that may occur in the course of doing business can be pre-empted, there are general obligations in the Code that attempt to reduce unacceptable business conduct. However, there are often substantial misunderstandings by different parties about these requirements.

This chapter of the report discusses a number of matters relating to enduring obligations during a franchise relationship, including:

- Good faith
- Management of marketing and other cooperative funds
- Change management in franchise systems

5.1 Good faith

Existing approach

Good faith is broadly understood as an obligation at law to act honestly and fairly when dealing with another party throughout the execution of a contract. When the Code was re-made in 2015, a codified version of this obligation was introduced, requiring all parties to a franchise agreement to act in good faith towards one another in respect of any matter relating to their agreement or the Code.¹¹⁴ This codified obligation also extends to the negotiation of a franchise agreement, and any dispute arising in relation to a franchise agreement.¹¹⁵

Under the Code, a focus is placed on the parties acting honestly, not arbitrarily, and cooperating to achieve the purposes of the agreement. The obligation to act in good faith does not prevent a party to a franchise agreement, or a person who proposes to become such a party, from acting in their legitimate commercial interests. Equally, good faith does not require a party to subordinate its interests to the counterparty.¹¹⁶

From 1 July 2021 the obligation to act in good faith was amended for new vehicle dealership agreements to provide that, in determining whether the obligation to act in good faith has been contravened, a court must have regard to whether the terms of the franchise agreement are fair and reasonable.¹¹⁷

Like the prohibitions on unconscionable conduct and misleading or deceptive behaviour in the ACL, the obligation to act in good faith prescribes a norm of conduct rather than a black and white rule.

114 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), clause 6.

115 *Ibid*, clause 6.

116 *Australian Competition and Consumer Commission v Geowash Pty Ltd* (No 3) [2019] FCA 72; 368 ALR 441 at 161 [746]

117 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), clause 6.

Such principles-based legislative provisions are regarded as providing flexibility to respond to evolving and unanticipated circumstances, and avoiding the problem of technical compliance which is against the spirit of the regulatory framework.¹¹⁸ The trade-off of this flexibility is that such provisions can be open to differing interpretations, with increased potential for dispute over the obligations each party has to the other. Principles-based laws can also be more difficult to enforce, since they require a more nuanced approach to adduce evidence that demonstrates a failure to uphold the obligation.

The obligation to act in good faith under the Code was recently examined in the high-profile dispute between the Mercedes-Benz OEM and its automotive dealership network in Australia (see Case study 1).

118 OPC, *Reducing complexity in legislation*, p 17.

Case study 1: AHG WA (2015) Pty Ltd v Mercedes-Benz Australia/Pacific Pty Ltd [2023] FCA 1022 (the ‘Mercedes-Benz Case’)

On 18 October 2021, 38 Mercedes-Benz dealers in Australia filed a claim in the Federal Court of Australia against the Mercedes-Benz car manufacturer for an alleged loss of \$650 million in goodwill after they received notice of non-renewal of their dealer agreements.¹¹⁹ The case was litigated under both the CCA and the Code. It tested the obligation to act in good faith in the context of franchising agreements, including an analysis of the new automotive-specific obligation to act in good faith contained in subclause 6(3A).

The case was triggered by the manufacturer’s decision to change its distribution model in Australia from a dealership channel to a fixed price agency model. It proposed to give effect to this transition at the point of expiry of existing franchise agreements, with the agency model embedded in new agreements offered to the dealers. The dealers considered that their businesses would be less profitable under the new franchise agreements and alleged that the issuing of the non-renewal notices was in breach of the manufacturer’s obligation to act in good faith. Among other things, the dealers submitted that the non-renewal power was constrained so it could only be exercised if the dealer failed to meet its sales targets, was in breach, or failed to make mutually agreed improvements. That is, that the obligation to act in good faith provided a degree of security of tenure in relation to franchise agreements if the dealer was performing in line with the agreement.

The OEM’s position was that it did not breach the good faith obligation, as it was acting to protect its legitimate commercial interests, as outlined in subclause 6(6) of the Code. It argued that the changed business model was a response to market forces and technological changes in the industry.¹²⁰

Judgment was handed down in favour of the OEM on 30 August 2023. In his decision, Justice Beach noted that ‘Good faith does not require a party to subordinate the party’s own interests. This principle is reflected in the Code, under which a franchisor is entitled to prefer its own commercial interest if there is competition between its interests and those of franchisees.’¹²¹

Justice Beach found that the dealers’ comparative disadvantage was in part self-induced by the dealers’ entry into the dealership arrangements in the first place. He considered the dealers had made a commercial judgment to accept the risks in the agreement, including the risks inherent in the manufacturer having a contractual power to issue non-renewal notices without cause, and noted the dealers themselves also had the right to terminate the agreement with 60 days’ notice. The judgment found that the manufacturer validly exercised a contractual right, and that this was not in breach of the obligation, despite only being beneficial to the OEM.

The case demonstrates that the obligation to act in good faith does not give legal force to the commercial expectations of franchisees that they will be able to operate a franchise over a period beyond the term stated in the franchise agreement. In doing so, the case demonstrates the importance of the express terms of the contract agreed to by the parties.

119 *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth & Westpoint Star Mercedes-Benz & Ors v Mercedes-Benz Australia/Pacific Pty Ltd* [2023] FCA 1022.

120 *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth & Westpoint Star Mercedes-Benz & Ors v Mercedes-Benz Australia/Pacific Pty Ltd* (2023) at 108 [662].

121 *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth & Westpoint Star Mercedes-Benz & Ors v Mercedes-Benz Australia/Pacific Pty Ltd* (2023) at 553 [3088].

What we heard

There is general acceptance among the franchising sector that the parties should act in good faith toward one another. However, many stakeholders raised concerns that the obligation to act in good faith can be mistakenly interpreted by franchisees as to what the franchisor is required to do.

Clause 6 of the Code is designed to assist both parties to act in good faith and to avoid any potential deceptive practices. However, in practice, these obligations are causing a level of confusion for both parties because they are vague and open to interpretation.¹²²

The ACCC submitted that franchisors' alleged failure to act in good faith is consistently one of the top 3 issues raised by franchisees. This is consistent with franchisee submissions to the review, who reported that some franchisors fail to act in good faith not only during their franchise agreement but prior to entry, during renegotiation and on exit. Many stakeholders commented on concerns about a perceived failure to act in good faith during dispute resolution. Stakeholders argued that franchisors include clauses that are disadvantageous to the franchisees and may refuse to negotiate on them, or if they do, it is simply a 'tick-the-box' exercise to give the appearance of acting in good faith.

The franchisor is not acting in good faith by seeking to introduce a term that is demonstrably not fair or reasonable.¹²³

However, the ACCC noted that the good faith obligation does not require a franchisor to meaningfully negotiate the terms of an agreement, avoid situational disadvantage or refrain from exercising rights under an agreement that are to the detriment of the franchisee.¹²⁴

Many franchisees were concerned that the obligation did not require the franchisor to disregard their own commercial interests in favour of the collective or individual interests of franchisees.

It [good faith provisions] makes clear that franchisors have no duty to apply any balance as to their interests where those interests are in conflict with the interests of franchisees. Franchising, under the current code, is therefore, a licence to exploit.¹²⁵

Franchisees recommended the provisions be clarified and strengthened. Suggestions included the use of examples in the Code, or further clarity regarding what is a 'legitimate commercial interest'. It was also suggested that franchisors be required to consider, and justify, the impact of commercial decisions on franchisees before acting in their own commercial interests.

The lack of a clear definition and actions that may be taken to accord with 'legitimate commercial interests' result in misunderstandings, uncertainty and frustration for business owners, most commonly franchisees.¹²⁶

On the other hand, franchisors generally felt they were constrained by the obligation to act in good faith. They submitted that the obligation limits their opportunities to decisively act where there is a

122 Australian Automotive Aftermarket Association (AAAA), *The Australian Automotive Aftermarket Association Response to the Franchising Code of Conduct Consultation Paper*, AAAA, p 8.

123 Anonymous franchise (private and confidential submission), *Review of the Franchising Code of Conduct*.

124 ACCC, *ACCC Submission*, p 3.

125 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 3.

126 ASBFEO, *Franchising Code Review Submission*, p 4.

need to remove a poor performing franchisee who is causing the brand significant damage, as they may be perceived to be in breach of the obligation.

The potential impact on brand damage is significant and our consultation has led us to put forward the view that the current system has flaws that create a strained relationship between franchisees and franchisors and potential collateral damage as other stores are affected by the economic and brand damage that can be inflicted by one individual store.¹²⁷

Some stakeholders believe the obligation is clear, manages to achieve what it has set out to do and does not require any changes.

The FCAI notes that the Mercedes Case provides considerable additional clarity in relation to the application of the good faith principle to motor vehicle agreements. The FCAI does not support any further legislative change in this area, as the law is clear and any ambiguity has been clarified by the Mercedes Case decision. The Code should not contradict or differ from clearly established legal principles.¹²⁸

Observations

The obligation to act in good faith has a long case law history and is a well-established common law principle. Clause 6 is intended to codify rather than substantially modify the obligation under common law.¹²⁹ Failure to meet the obligation to act in good faith is a high bar, but not as high as unconscionable conduct, which was originally considered as an alternative but deemed to require too onerous a standard of proof for the purposes of franchising.

Although concern has been expressed about the unclear nature of the good faith obligation, the development of jurisprudence in this area is providing clarity and guidance to the sector on what is, and is not, required from the parties to meet the obligation. The recent Mercedes-Benz Case, along with other judgments such as the 2017 Pizza Hut case, have made it clear that the franchisor is not required to subordinate its commercial interests or relinquish its advantageous negotiating position.¹³⁰ While some element of uncertainty will remain, this is a feature of flexible principle-based laws.

Codification of specific actions that could be considered a failure to act in good faith, or attempting to clarify what is or is not a 'legitimate commercial interest,' would likely be contentious. It would undermine the clear jurisprudence that has now developed, could potentially lead to further confusion about the obligation, or might limit the intended flexible nature of this provision.

The Code provides minimum standards for the relationship between franchisors and franchisees, while the ACL provides important alternative norms of conduct. These norms operate to further contain franchisor behaviour and protect against certain practices such as unconscionable conduct or

127 AAAA, *The Australian Automotive Aftermarket Association Response to the Franchising Code of Conduct Consultation Paper*, p 8.

128 FCAI, *Federal Chamber of Automotive Industries Submission to the Review of the Franchising Code of Conduct Consultation Paper*, p 26.

129 *Explanatory Statement, Competition and Consumer (Industry Codes – Franchising) Amendment (Fairness in Franchising Regulations) Regulations 2021* (Cth), item 2.

130 *Virk Pty Ltd (in liq) v YUM! Restaurants Australia Pty Ltd* [2017] FCAFC 190.

misleading and deceptive conduct. The obligation to act in good faith must remain flexible to adapt to the changing legislative landscape it exists within.

On balance, no further adjustments or changes are recommended regarding the obligation to act in good faith at this time. The current Code obligation is appropriately calibrated to the nature of franchising, as distinct from other business models. Good faith should not operate so as to confer benefits that contradict the express terms of a franchise agreement.

The continued development of case law and the broader protections contained in the ACL will, over time, most likely better educate participants as to the nature and extent of the obligation.

Good faith in the context of end of term arrangements and dispute resolution is discussed further in Chapter 7.

5.2 Marketing and other cooperative funds

Existing approach

Franchisors typically require franchisees to pay a fee to the franchisor for the purposes of marketing and advertising the brand. These fees are usually pooled together and can be known as marketing funds or cooperative funds. Although a franchisee may pay fees to a marketing fund, the franchisor generally controls spending from the fund. Franchisors must provide details about what the fund is to be used for, who administers it, and how it was spent over the previous year as part of the disclosure documents. How the marketing funds can be spent, and auditing requirements, are regulated by clauses 15 and 31 of the Code.

Clause 15 regulates financial statements for marketing funds and other cooperative funds. If a franchisee is required to pay money into a marketing or other cooperative fund administered by the franchisor, the franchisor must provide audited information about the fund's receipts and expenses to franchisees annually. The annual financial statement must set out meaningful information about sources of income and items of expenditure. If 75% of franchisees agree, the requirements in relation to audit of the fund do not apply.¹³¹

Clause 31 outlines that franchisors who operate a marketing fund must maintain a separate bank account for the fund and contribute to the fund on the same basis as franchisees for each company-owned store that a franchisor operates. Marketing and advertising fees may only be used to meet expenses that have been disclosed to franchisees, agreed to by a majority of franchisees, or are legitimate marketing expenses.¹³² Any breach of the obligations around marketing funds and cooperative funds attracts a potential sanction of 600 penalty units.¹³³ Marketing funds are not generally treated as being held in trust for franchisees.¹³⁴

131 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 15.

132 *Ibid*, schedule 1, clause 31.

133 *Ibid*, schedule 1, clauses 15(2) and (4). *Crimes Act 1914* (Cth), section 4AA states that as of 1 July 2023, the value of a penalty unit is \$313.

134 *Stay in Bed Milk & Bread Pty Ltd (In Liq)* [2019] VSC 181.

There has been a prior history of concerns in relation to marketing funds, and the ACCC has previously undertaken litigation in this area (see Case study 2), as well as producing education and awareness materials on the topic.

Case study 2: Michel's Patisserie

On 15 December 2020, the ACCC commenced court proceedings in the Federal Court against Retail Food Group Ltd (ASX: RFG) and five of its related entities for conduct occurring between 2015–2019. As a part of the allegations, the ACCC claimed that RFG engaged in unconscionable conduct by making payments from its Michel Patisserie's marketing fund for expenses that were not legitimate marketing expenses. These included operational and other expenses, some of which were incurred in implementing a business model change in which fresh cake products were replaced by frozen cake products supplied via third party distributors.¹³⁵

Franchisees claim their businesses suffered following the transition to selling frozen cakes, as they were forced to sell lower-quality defrosted cakes and pastries instead of being delivered fresh food daily. As the quality plummeted, the businesses suffered significant damage to the reputation and brand.¹³⁶

RFG's franchise agreements required that franchisees contributed a weekly marketing and promotion fund fee, which was deposited into a marketing fund administered by RFG. These payments from the marketing fund were not for legitimate marketing or advertising expenses, nor were reasonable costs properly attributable to the cost of administering or auditing the fund, and they had not been disclosed to franchisees in the disclosure document. These payments were improper and benefited RFG while being made at the expense of the franchisees. The ACCC also claimed that RFG did this without adequately disclosing it to its franchisees or seeking agreement from the majority of franchisees.¹³⁷

On 23 December 2022, as a part of a court enforceable undertaking accepted by the ACCC, RFG paid \$5 million to Michel Patisserie's franchisees who paid levies into that franchise's marketing fund between 1 July 2012 and 30 June 2017.¹³⁸

135 ACCC, *ACCC alleges RFG engaged in unconscionable and misleading conduct*, ACCC website, 15 December 2020.

136 ACCC, *ACCC alleges RFG engaged in unconscionable and misleading conduct*, ACCC website, 15 December 2020.

137 ACCC, *Undertaking registers: Retail Food Group Ltd*, ACCC website, 22 December 2022, accessed 8 November 2023.

138 Ibid.

What we heard

Relatively few stakeholders raised concerns about the operation and regulation of marketing funds. However, regulators submitted that marketing funds remain a common source of complaints raised with them. Some stakeholders also commented on a perceived need for additional transparency and involvement of franchisees in allocation of these funds.

Franchisors regularly use such cooperative funds to pay for activities that are not directly related to promoting the franchisees' business. Also, franchisee [sic] object to their funds being used for marketing that relates only to brand equity. They do not have any equity in the brand, and see this as a cost that should be borne by the franchisor.¹³⁹

Various stakeholders sought explicit guidelines for marketing fund expenditure, while others suggested a requirement for there to be a board of franchisees within each franchise with a decision-making power over how the funds are disbursed. Franchisees tended to see the money as theirs and argued that the expenditure of funds should benefit them on an individual level, not just the brand overall.

Concerns were also raised that any additional regulation of these funds may push more franchisors into alternative ways of managing their marketing expenses, in an attempt to avoid additional compliance burdens.

The ACCC considers that further limitations on how franchisors utilise marketing funds will only encourage more franchisors to abandon marketing funds.¹⁴⁰

It was claimed that some franchisors have introduced higher franchise fees which incorporate marketing expenses, and thus avoid the auditing requirements of a marketing fund. It was argued that a more wholistic view should be considered to lessen this type of avoidance behaviour. Rather than having these obligations imposed on only the franchisors with explicit marketing funds or cooperative funds, all franchisors should be accountable for marketing expenses more generally.

I would be happy to pay a higher franchise fee knowing that there is nothing sneaky or been less than honest is going on in the Head Office.¹⁴¹

Some stakeholders recommended that marketing funds should be held in trust for franchisees, noting this provides the opportunity for such funds to be returned to franchisees if the franchisor goes into liquidation.

Unless specified in the franchise agreement the 'separate account' is not a trust account although it is funded by franchisees, and any franchisor owned outlets. Marketing fund balances, potentially 7 figures, are thus used by the liquidator to pay a failing franchisors creditors rather than the unspent funds being returned to the franchisees.¹⁴²

139 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 8.

140 ACCC, *ACCC Submission*, p 15.

141 *Franchisee Survey* [data set], October 2023, accessed 21 October 2023 (see appendix B for more details).

142 J Buchan, *2023 Franchise Regulation Review conducted for Australian Treasury by Dr Michael Schaper: Submission from Emeritus Professor Jenny Buchan*, PhD, LLB, p 10.

Observations

While it is clear that marketing funds are still a cause of some concern within the sector, little evidence was presented which indicated a widespread problem. The current regulations set out in the Code and enhanced educative efforts of the ACCC in this space appear to be adequately addressing these concerns; indeed, the ACCC is to be commended for focussing on education in this space, encouraging franchisors to be transparent and accountable for marketing funds.

The Code already allows for transparency in the form of an audit. This ensures that franchisors are accountable for their spending and that franchisees can raise concerns if necessary.

The intent of the Code is not to provide franchisees with decision making powers regarding how to market the franchise. Brand promotion is generally a core component of the expertise and ‘value add’ of many franchisors. Franchisors need a level of flexibility to ensure that the funds can be spent on necessary expenses to ensure the welfare of the brand as a whole. The suggested introduction of explicit guidelines and a franchisee board may unnecessarily narrow the ability of the funds to be used for the benefit of the franchisees in line with current needs of the entire brand. It is ultimately a matter of commercial judgment how to best market a franchise and regulation is generally not effective where it seeks to constrain such matters.

Open and transparent communication is consistent with general best practice regarding the franchisor demonstrating to franchisees the actions it takes to support the franchise brand and system, including marketing. Marketing and other cooperative funds should be operated in an open and transparent manner, consistent with the policy intent of the existing Code provisions. Franchisees want to know why money is being spent, what the money is being spent on and how it is adding value to the brand and business.

The review suggests that further franchisor-targeted education and best practice guidance could be developed to support productive working relationships with franchisees in areas such as the management of marketing funds.

While some concerns around the treatment of marketing funds upon insolvency persists, issues relating to insolvency are discussed further in Chapter 6.

5.3 Change management

Existing approach

The Code regulates change during the term of a franchise agreement through a number of different obligations. Disclosure documents are required to include details of any unilateral variations by the franchisor in the previous 3 financial years, and the circumstances in which the franchise agreement may be varied unilaterally in future.¹⁴³

Clause 17 requires that if certain materially relevant changes occur during the term of a franchise agreement, they must be disclosed to franchisees within a reasonable time of not more than 14 days.

143 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 17.

Such events include judgments entered against the franchisor, or a change in the majority ownership or control of the franchisor, or an associate of the franchisor.¹⁴⁴

Clause 30 prohibits a franchisor from requiring a franchisee to undertake significant capital expenditure during the term of the franchise agreement. There are certain exemptions to this, including situations where the expenditure is disclosed to the franchisee before an agreement is signed, or is agreed by the individual franchisee or a majority of franchisees, or is necessary to comply with legislative obligations.¹⁴⁵

Since the introduction of amendments made in 2021 relating to capital expenditure (including clause 31A which prohibits a franchisor from unilaterally varying a franchise agreement with retrospective effect), franchisors have had to include as much information as practical in the disclosure document about known significant capital expenditure that will be required during the term of the agreement.¹⁴⁶

What we heard

Many negative franchisee experiences reported to the review stemmed from changes that had occurred within a franchise system. In general, examples included new leadership or a franchisor's decision to make a significant change to the business model. Such changes were often seen as opportunistic, and/or being made solely to benefit the franchisors' interests, rather than being in the spirit of the original deal struck with the franchisee or in the interests of the broader franchise system.

In some such cases, a franchisee had operated happily for a long period prior to the change. For example, one franchisee who had been in operation for 22 years reported that their franchisor 'used to be ok but ownership and management changes and they don't care about their obligations anymore.'¹⁴⁷

Many stakeholders noted concerns over changes when a private equity firm or 'short-term CEO' took over the operation of franchisor entities. It was submitted that such changes often led to changes in the core business model to increase profit for the new owner, with little consideration of the long-term impact on franchisees.

The franchisor must not be permitted unreasonably to make or implement a decision which is likely to harm the franchisee's business.¹⁴⁸

Multiple franchisees presented their own personal experiences of poor change management, where they suffered significant financial loss, or the changes caused ongoing disruption to their business. Some stakeholders felt they were subject to the 'whims' of the franchisor and were encountering operational or marketing changes so regularly they had no ability to appropriately respond before another change occurred.

144 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 17.

145 *Ibid*, schedule 1, clause 30.

146 *Ibid*, schedule 1, clause 30A.

147 Anonymous franchisee (private and confidential submission), *Review of the Franchising Code of Conduct*.

148 S Levitt, *Submission to Franchising Review Secretariat Unit, Small and Family Business Division, The Treasury, Commonwealth of Australia*, p 6.

Suggestions were raised that it may be appropriate for compensation to occur where franchisees suffered significant losses due to failed changes. Others argued that where a change is so substantial that it goes to the core of the business model, they should have an express right to exit the business without penalty.

Franchisees should be allowed under the Franchising Code to exit the franchise without penalty should a franchisor significantly change the operating model or management of a franchisor.¹⁴⁹

Many franchisees expressed the view that the Code should require franchisors to consult or obtain the consent of franchisees to any changes to the business model, and take into account the views of franchisees before making any major changes.

The Code could mandate that franchise brands must introduce a Franchise Advisory Council once they have reached say 40 outlets or 40 franchisees ... which must also be consulted prior to the introduction of any major change likely to impact the franchise network. (This is established best practise in any event, so including this in the Code would not be particularly onerous).¹⁵⁰

However, franchisors argued that to maintain the viability of their brand they needed the ability to make change throughout the term of the franchise agreement.

Without the ability to improve, update, and adapt our brands over the course of 20-year contracts we could not operate a successful franchise system. The business landscape is constantly changing.¹⁵¹

Franchisors argued that making compensation compulsory ignores business reality; franchisees should know they have to adapt through the course of their agreement and that means they will need to incur costs. Franchisees acknowledged this to some extent but considered that the ethos of the Code meant that such changes should be done in good faith, equitably, and with effective remedies for franchisees.¹⁵²

Some franchisors reported that they did not make changes without careful review of the sensitivity that may arise from the change, and that they frequently update their franchisees on any proposed modifications. This included regular information sessions, and encouraging them to plan ahead and allow for significant lead time to ease the transition. Some franchisors considered existing reporting mechanisms and disclosure requirements to be adequate, although these could still be simplified to reduce red tape and administrative burden. A few suggested that further discussions around the risks and nature of any change, and providing a reasonable period of notice to implement such modifications, should be standard practice.

149 M Fraser and M Johnstone, *Submission: Franchising Review*, Franchise Redress, p 6.

150 J Gehrke, *2023 Franchising Code of Conduct review*, p 3.

151 Hilton Hotels of Australia Pty (Hilton), *Australian Government Review of the Franchising Code of Conduct submission*, p ix.

152 Anonymous franchisee (private and confidential submission), *Review of the Franchising Code of Conduct*.

With insufficient flexibility to make changes to terms, the Code can be restrictive and prevent a franchisor rolling out change ... The Code should recognise the special relationship and allow for change (together with a process to allow it to occur).¹⁵³

Franchisors raised some concerns over the potential of the UCT regime to restrict their ability to implement system changes, even where there is a general contractual provision allowing them to do so.

Observations

Any long-term agreement which gives effect to a relationship between two parties must account for the need to adapt the terms of the agreement to meet changing circumstances. Without this flexibility, franchise systems would be unable to evolve and adapt to market conditions. In many instances they would be unable to compete effectively with firms operating in non-franchised structures. While being adaptable to changing market forces and consumer preferences has always been important for business, it is becoming increasingly important as the pace and intensity of change is accelerated by technology, rapid variations in customer demand, and other shocks like the COVID-19 pandemic.

It is not always possible to foresee all changes which may be required over the term of a franchise agreement, nor to disclose them in advance.

Notwithstanding this, management of change within franchise networks is a major concern for franchisees. Poor change management practices can erode trust and damage relationships between franchisors and franchisees. At worst, it can result in costly disputes unfolding within a franchise network. Unilateral variation of franchise agreements or other changes to the management structure or business model can also undermine the value of franchisees conducting due diligence prior to entering into a franchise agreement. Even if a franchisee has thoroughly researched the business model and satisfied themselves as to the skills and expertise of the franchisor ownership prior to entering the agreement, this does not protect them if the business model and ownership can both be changed shortly after the franchise agreement is signed.

As such, there are ongoing questions about whether and how franchisees should be compensated for change, franchisees' ability to resist change, or even franchisees' capacity to exit a franchise system without penalty if there are significant changes to the operating model or management of a franchisor.

However, regulation is generally not well placed to create detailed rules about what kind of change is acceptable or unacceptable – such matters ultimately go to the management expertise, business judgment and organisational acumen of commercial entities. Principle-based laws, such as the obligation to act in good faith and the UCT regime are an appropriate 'safety net' in the context of change management in a relationship. However as discussed earlier in this chapter, good faith does not ensure that the interests of franchisees are paramount in any decisions made by the franchisor.

Given the degree to which change appears to be a driver of disputation, further education of franchisors is needed to improve business practices. As noted elsewhere in this report, education is important not only for franchisees but also for franchisor entities, many of whom are themselves

153 QLS, *Submission to the Review of the Franchising Code of Conduct*, p 11.

small businesses and may not have access to expertise on best practice change management or in developing a culture that supports innovation. Such guidance could be prepared jointly by the ACCC and ASBFEO, noting that ASBFEO's functions include promoting best practice.¹⁵⁴

The most successful franchise relationships have clear processes for how change is managed within their franchise system. They typically have, for example, policies around how change is communicated and consulted upon, and how it is effectively rolled out to smooth the process of transition among a franchise network. Organisational psychology is an area rich in advice to support effective change management within large and complex organisations such as franchises.

5.4 Findings and recommendations

Findings	
XIII. Over time, decisions made by the courts are providing guidance to franchisors and franchisees on what is required to act in good faith under the Code. Such decisions should be used by regulators to develop education, particularly for franchisees, as to the limitations of good faith in a grievance.	
XIV. Change management continues to be a problematic area for many franchise relationships.	
XV. Some franchisors are not employing best practice relating to the transparent and effective operation of marketing and cooperative funds.	
Recommendations	Implementation suggestions
12. Franchise systems should be encouraged, through education, to consult franchisees regarding any major change to the business model during the term of the franchise agreement.	12A. Relevant Australian Government agencies should support franchisor targeted education and provide best practice guidance on how to manage change and support productive working relationships with franchisees. Sector participants could work together with the ACCC and ASBFEO to develop appropriate guidance.

¹⁵⁴ The Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth), section 64.

Chapter 6: Ending a franchise relationship

Long-term contracts such as franchise agreements should be able to be concluded in a way that is reasonable to both parties, especially when it is a result of early termination or the expiry of the term of the agreement.

This chapter provides an overview of the issues arising when a franchise agreement concludes, including:

- Early termination by the franchisor
- Early termination by the franchisee
- Non-renewal and expiry of franchise agreements
- Goodwill and restraint of trade
- Insolvency.

6.1 Early termination initiated by the franchisor

Existing approach

The situations in which a franchisor can terminate an agreement are set out in clauses 27 and 28 of the Code. A franchisor can terminate for breach of the franchise agreement or if there are terms contained within the agreement that allow for early termination.¹⁵⁵ When a franchisor seeks to terminate an agreement early, the Code sets out certain requirements, such as those relating to dispute resolution processes. The Code requires franchisors to provide reasonable notice of any proposal to terminate or, if the termination is because the franchisee has breached the agreement, an opportunity must be provided for the franchisee to remedy the breach.¹⁵⁶

Previously there were certain circumstances in which the franchisor could immediately terminate the agreement, including when the franchisee had become insolvent, acted fraudulently, or operated the business in a way that endangered public health or safety.

Amendments to clause 29 of the Code in 2021 introduced a requirement for a franchisor to give 7 days' notice of any proposed termination. Following the notice, the franchisee has an opportunity to dispute the termination and refer the matter to an Alternative Dispute Resolution (ADR) process.¹⁵⁷ During this time, a franchisor can direct a franchisee to cease operating the business only if such a right already exists in their franchise agreement.

Code requirements applicable to new vehicle dealerships include a provision that franchisors can only enter into new agreements if the agreement provides for compensation for early termination where the franchisor withdraws from the Australian market, rationalises its networks or changes its

¹⁵⁵ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clauses 27 and 28.

¹⁵⁶ *Ibid*, schedule 1, clause 29.

¹⁵⁷ *Ibid*, schedule 1, clause 29.

distribution models in Australia.¹⁵⁸ The agreement must also specify how the compensation is determined and how the franchisor is to buy back or compensate for certain inventory.

What we heard

Franchisor submissions to the review argued that the 2021 requirements for termination needed to be amended to allow for immediate termination of a franchise agreement in certain circumstances. While fraud and breaches of public health and safety are existing grounds for early termination, most franchisors said the scope for termination was insufficient to address other egregious behaviour that could damage a franchise brand, the franchisee's employees and relevant third parties. This might include underpayment of staff by franchisees, or repeated non-compliance with operational requirements. Franchisors raised specific concerns about instances where franchisees were charged (but not convicted) with indictable offences, including physical and sexual assault.

Brand owners face increased regulatory obligations for network compliance, and community expectations do not distinguish between franchisor and franchisee liability in a branded network. Accordingly the Code must enable brand owners to protect the brand, and indeed other franchisees, where there has been a serious breach of the law.¹⁵⁹

Franchisors argued that recalcitrant franchisees may dispute breach notices, the proposed termination notice and opportunistically utilise ADR processes to delay termination of the agreement. If the franchisor undertook court action, so-called early termination of an agreement could in fact take months or years.

These arrangements continue to be of concern to Australia Post – the underlying 'special circumstances' at play here ... are circumstances that warrant a franchisee's immediate removal from the franchised business ... in the event of demonstrated wage underpayment or sexual harassment / assault – in such situations, to delay leaves franchisee employees at risk of further mistreatment or coercion.¹⁶⁰

Some franchisors suggested the Code should be aligned with existing termination provisions within the Oil Code. These provisions provide for immediate termination of the agreement after 3 breach notices have been issued. Franchisors that operate connected businesses each regulated by separate codes suggested that harmonisation of termination provisions was desirable.

Under the Franchising Code, a franchisee could continuously breach, remedy that breach within a 'reasonable' period and continue to do so on a significant number of occasions and the franchisor is unable to terminate a franchisee for continuous breaches. However, under the Oil Code, franchisors have a right to terminate immediately if 3 breach notices have been issued (that is, to prevent reoccurrence of breaches).¹⁶¹

158 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 46A.

159 FCA, *Strengthening the Franchising Code*, p 6.

160 Australia Post, *Australia Post Submission*, Australian Postal Corporation, pp 3–4.

161 7-Eleven, *7-Eleven Submission to the Review of the Franchising Code of Conduct Consultation paper*, 7-Eleven, p 3.

Submissions also noted that franchisors are increasingly accountable for their network's compliance with legislative requirements, such as the provisions introduced into the *Fair Work Act 2009* (Cth), subsection 558B(1) and (2). This section holds franchisors and holding companies responsible for certain contraventions of the Act by their franchisees or subsidiaries where they knew or ought reasonably to have known of the contraventions and failed to take reasonable steps to prevent them.¹⁶² The FCA's submission raised this issue of increased accountability and the need for the franchisor to act quickly to protect their brand and network.

The Code must enable brand owners to protect the brand, and indeed other franchisees, where there has been a serious breach of the law.¹⁶³

However, franchisees raised concerns about the ability of a franchisor to terminate their agreement early. Many franchisees submitted that breach notices and threats of early termination were used to force through operational changes. Several franchisees alleged that franchisors profited from or avoided paying compensation to the franchisee by using these tactics. Some legal representatives of franchisees provided a similar view on the issue of early termination by the franchisor.

Franchisors frequently look for ways to induce, engineer or use entrapment to uncover fault by a franchisee, in order to use it as a pretext to allege fraudulent conduct or repeated breaches (3 strikes and your [sic] out) under clause 29 of the Franchising Code and clause 36 of the Oil Code, entitling the Franchisor under the Codes to terminate a franchise summarily without a requirement to offer adequate compensation.¹⁶⁴

Many franchisees' submissions acknowledged the need for a franchisor to address serious misconduct by a franchisee and minimise brand damage. However, franchisees argued for robust safeguards to avoid the misuse of such provisions.

Any decision by the franchisor to terminate a franchisee's agreement should be based on fair and objective criteria. These criteria should form part of the contract and be the only basis on which a franchisee can be terminated. Breach notifications giving grounds for termination should be of such a standard as to pass a test of reasonableness. The franchisee is at risk of losing their massive investment, often their home and, nearly always, their career.¹⁶⁵

The FCA reiterated their support for enhanced termination rights for franchisors if the franchisee was compensated, noting that more than three-quarters of their members had supported this proposition in a recent survey.¹⁶⁶

Automotive franchisor representatives submitted that it was too early to assess the impact of the new vehicle dealership compensation clause 46A.

162 See *Fair Work Act 2009* (Cth), section 558B.

163 FCA, *Strengthening the Franchising Code*, p 6.

164 S Levitt, *Submission to Franchising Review Secretariat Unit, Small and Family Business Division, The Treasury, Commonwealth of Australia*, p 5.

165 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 8.

166 FCA, *Strengthening the Franchising Code*, p 6.

The FCAI is not aware of any instances since the inclusion of clause 46A in the Code in which circumstances have occurred that would result in this clause being tested. As such it is too early for the FCAI to draw any conclusions on the costs and benefits of that specific element of the Code.¹⁶⁷

Most franchisees stated that the Mercedes-Benz court case had undermined the right for compensation contained within clause 46A.

The Mercedes-Benz Case was based on agreements entered into before the 2021 provisions were legislated. Automotive franchisees and franchisors agreed it was unlikely clause 46A would have changed Justice Beach's ruling, because the case concerned the *non-renewal* of franchise agreements as distinct from *early termination* of the agreement. Furthermore, the compensation calculation was informed by the remaining term of the franchise agreement and not the goodwill associated with the sale of the business as a going concern.

It is apparent that clause 46A offers no practical protections to dealers who have a fixed term agreement with respect to compensating them for the loss of opportunity to sell established goodwill where there is a prescribed early termination event.¹⁶⁸

A dealer with only a fixed term agreement would therefore only have a right to be compensated under a clause 46A early termination event for lost profit from direct and indirect revenue and the other elements specified in clause 46A – but not for the loss of opportunity to sell established goodwill.¹⁶⁹

Franchisees representatives outside the automotive sector suggested clause 46A should be extended to all franchise agreements. They argued that the provision would provides greater certainty about compensation in the event of a franchisor terminating an agreement early.

Observations

The regulatory framework in the Code must strike an appropriate balance between early termination provisions and protection of franchisee interests.

Franchisors must be able to take decisive action when warranted to protect their brand and network. The actions of disaffected individual franchisees within a franchise system may lead to significant brand damage and impact other franchisees in the network.

The current provisions allowing for immediate franchise termination have attempted to balance these competing considerations. However, an unintended consequence of the 2021 changes is that in certain circumstances it may be unduly difficult for franchisors to take decisive action. Serious misconduct is a concern given the potential harm a franchisee can cause to third parties, such as employees and customers, where the circumstances are sufficiently severe. Franchisors acknowledge that these incidents are rare, but when they occur, there is a need to resolve the termination of the franchisee as soon as possible.

¹⁶⁷ FCAI, *Federal Chamber of Automotive Industries Submission to the Review of the Franchising Code of Conduct Consultation Paper*, p 23.

¹⁶⁸ Australian Automotive Dealer Association (AADA), *Response to the Review of the Franchising Code of Conduct Consultation Paper*, AADA, p 3.

¹⁶⁹ MTAA, *MTAA 2023 Franchising Code Review Submission*, p 16.

Changes to clause 29 should be considered to ensure that, where appropriate, franchisors can take decisive action to immediately terminate a franchise agreement. However, there is also a need to retain checks and balances to guard against misuse of early termination provisions by franchisors. This could include more substantial rights to immediate termination if the franchisee is paid compensation.

Due to a lack of any known instances of early termination occurring in the automotive sector, there has been no opportunity to assess the effectiveness of the additional termination provisions for new vehicle dealerships.

For the last two years, the automotive sector has been characterised by strong sales and margins on new car sales. It is unlikely that the automotive provisions, specifically clause 46A, will be tested while profits for dealerships, distributors and manufacturers remain high.

Stakeholders from other industries were generally of the view that it would be desirable to spell out compensation for early termination before entering an agreement.

6.2 Early termination by the franchisee

Existing approach

From time to time, individual franchisees may wish to leave a franchise earlier than planned. This can occur for any number of reasons, including (but not limited to) personal circumstances, lower than expected returns, or poor franchisor relations. The situations in which a franchisee may seek early termination of an agreement are included in the franchise agreement.

Clause 26B recognises the franchisee's right to request early termination of an agreement. There is a timeframe within which the franchisor must respond to the request and, if applicable, provide the reason(s) for the refusal of an early termination request.¹⁷⁰

What we heard

Submissions raised no significant concerns about the impact of the 2021 changes, in which clause 26B was created. Its purpose was to ensure franchisees had the right to request an early exit from their agreement. Franchisors are required to consider and respond to the request in a timely fashion. Clause 26B provides a mechanism to mutually initiate a discussion between the parties to minimise losses. Allowing one party to terminate a contract early is a commercial decision involving many variables.

Franchisees told the review that the request for early termination often occurred when they were under financial duress. If their request for early termination was refused, it was difficult for them to seek further legal advice due to the cost involved. Franchisees and legal advisors acknowledged the possibility of a franchisor's refusal constituting unconscionable conduct or breach of good faith obligations; however, this was considered a high bar to establish.

¹⁷⁰ See *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 26B.

On one view, the early termination request process may be considered ineffectual, given that the franchisor retains the power to refuse a request, albeit with reasons. On another view, the parties' interests are sufficiently balanced, as a franchisor refusal may amount to a breach of the Code's good faith obligations or constitute unconscionable conduct.¹⁷¹

Some franchisee submissions argued that a right of early termination should exist if significant change has occurred in the franchise system and differs from the initial disclosure and franchise agreement. The ACCC's submission reiterated these concerns and suggested that the Code should address these circumstances.

Franchisors indicated they had received few requests from franchisees for early termination. For those that did, some requests were problematic.

Our observations indicate that early exit requests primarily come from underperforming franchisees facing challenges in selling their businesses. In such cases, franchisors may hesitate to accept an early exit or repurchase the business (usually due to disparities in the purchase price). Furthermore, when a franchisee is underperforming, franchisors often have more favourable contractual alternatives at their disposal for terminating the franchise agreement and/or repurchasing the business.¹⁷²

For other franchisors, the issue of an early exit request was complicated by retail leasing agreements. When a franchisor is a party to a retail lease and the franchisee cannot meet the leasing fees, the franchisor can be subject to penalty and surrender fees.

Observations

A franchisee's ability to request early termination from an agreement has now been in existence since 2021, but awareness of this provision appears to be low.

Very few franchisee submissions indicated that they knew of their right to request an early termination of the agreement. Franchisors reported that they had not received many requests for early termination. It was clear from submissions that there is uncertainty about the grounds for requesting and refusing a request for early termination. For some franchisors, there was no incentive to entertain a request for early termination by a franchisee. Nonetheless, some participants provided examples of franchisors working collaboratively with unviable franchisees to exit an agreement. In these instances, facilitating an early exit was seen to be beneficial for both parties.

On balance, no further changes to the regulation of early termination initiated by the franchisee are warranted. The 2021 changes have provided a right for franchisees to request an early exit from their agreement. However, more awareness of these provisions is needed before further regulatory change should be contemplated. This could be achieved through best practice guidance and education of both franchisors and franchisees regarding franchisee requests for termination under Clause 26B. Moreover, the newly-expanded UCT regime may also have an impact on franchise termination issues (for example, if the franchise agreement allows one party but not the other to terminate a contract).

171 Law Council of Australia, *Review of the Franchising Code of Conduct*, p 9.

172 C Heggelund, *Guzman Y Gomez submission*, Guzman y Gomez (Holdings) Limited, p 4.

6.3 Non-renewal and expiry of franchise agreements

Existing approach

The franchise agreement determines whether the franchisee will have any rights or options relating to the renewal of an agreement. The Code ensures that franchisees are entitled to updated disclosure materials when an agreement is renewed. However, it is worth noting that the Code does not grant any statutory or automatic right to renewal.

The Code does require a degree of transparency regarding the end of a franchise agreement. Before the end of the term of an existing agreement, franchisors and franchisees must notify each other as to whether they intend to continue in the franchise relationship.¹⁷³ The notice period is 6 months but extends to 12 months for new vehicle dealerships.¹⁷⁴

For new vehicle dealerships, if either party in a dealership agreement does not intend to continue the relationship, they must provide reasons as to why. OEMs must also agree on a 'winding down' plan with new vehicle dealerships, which sets out how the franchisee's stock will be managed.¹⁷⁵

What we heard

Many submissions raised tenure length and non-renewal as critical issues, although only a few submissions addressed the adequacy of the notification period.

Franchisees sought more certainty regarding tenure length and non-renewal. They argued that certainty of tenure and renewal was critical for the opportunity to earn a return on their investment. Most franchisees suggested that the current automotive provisions, particularly the opportunity to earn a return on investment, should extend to all franchisees.

When discussing tenure and non-renewal, franchisees reported that many issues compounded their concerns about non-renewal or expiry of their franchise agreements. Many franchisees alleged that unilateral changes to operations manuals, supply chain lock-in and inflated pricing, increased audits, and misuse of breach notices escalated before the expiry of their franchise agreements. Some franchisee submissions alleged that these behaviours were used to force them from their franchise, so their franchise could be sold or converted to a corporate store.

At the very least the [Mercedes] decision legitimises the phenomenon known as burning and churning, where the franchisor deliberately repossesses a franchisee's business usually at the end of the first term and then resells it to gain the benefit of all the going in fees and charges.¹⁷⁶

173 This requirement is reduced to 6 months in circumstances where the term of a franchisee agreement is less than 12 months.

174 See *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 18 generally, or clauses 47 and 48 in relation to dealerships.

175 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 49.

176 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 8.

Many franchisees said they felt they had no choice but to accept a new agreement on a 'take it or leave it' basis.

At the expiration of our current agreements, we have the choice of accepting the terms that will have a significant impact on our profitability and value of our business, or surrender the business back to the franchisor, effectively walking away from the goodwill we have built over the last 10 or 20 years. Again, we ask, how can this be legal?¹⁷⁷

Franchisees believe they are buying and dedicating themselves to a long-term opportunity. Continuity of tenure should be the default position. Any decision by the franchisor to terminate a franchisee's agreement should be based on fair and objective criteria.¹⁷⁸

Retail leasing in shopping centres was raised in many submissions to the review. Small business commissioners across Australia flagged the preponderance of leasing issue complaints. Some franchisors, especially those who acted as the head lessee for their franchisees, commented that where leases cannot be renewed, this may also trigger an effective non-renewal of their franchise agreement. The FCA commented that:

In recent times landlords are seeking rental from tenants that were unable to trade during Covid, plus CPI rental increases under leases, whilst at the same time offering new tenants substantial rental discounts ... By far the major cause of most franchising disputes can be traced to the conduct of major shopping centre landlords.¹⁷⁹

Automotive franchisors and franchisees agreed that the 2020 reform, which introduced a 12-month end-of-term notification requirement, had yet to be broadly tested. However, automotive franchisee representatives commented that the new provisions might have unintended consequences for new vehicle dealerships by encouraging shorter-term tenure lengths.

OEMs and Dealers are now required to provide a reason when they do not renew an agreement. They are also required to provide 12-months' notice if they intend not to renew an agreement. Unfortunately, the regulations allow the 12-month requirement to be waived if the agreement is for a period of less than 12-months, in which case the notice period is 6 months. It also reduces the notice period to one month if the agreement is 6 months or less. There is a real risk that this element of the regulations will result in OEMs offering shorter terms so that they can provide the shortest notice period possible.¹⁸⁰

Most submissions acknowledged that the imposition of minimum and maximum tenure lengths was undesirable. Establishing minimum tenure lengths would not address the issues leading to disagreements concerning non-renewal and expiry of franchise agreements. Many submissions noted that adopting a 'one-size-fits-all' standard tenure requirement may have unintended consequences because of the diversity of industries covered by the Code.

177 Anonymous franchisee (private and confidential submission), *Review of the Franchising Code of Conduct*.

178 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 8.

179 FCA, *Strengthening the Franchising Code*, p 23.

180 AADA, *Response to the Review of the Franchising Code of Conduct Consultation Paper*, p 9.

Observations

Non-renewal of franchise agreements continues to be a cause of concern for franchisees. However, there are no enduring legal rights concerning renewal of the agreement or renewal on the same terms.

Outside the automotive sector, many submissions commented on the usefulness of clause 46B, which requires that a franchisor not enter into a new vehicle dealership agreement unless the agreement provides a reasonable opportunity for a return on the franchisee's investment. For many, clause 46B was the most helpful way to inform franchise negotiations and agreements. Many franchisor and franchisee submissions agreed that the term of a franchise agreement should, in principle, reflect the level of investment and provide the opportunity to earn a return on the investment during the agreement.

It is also important to note that external factors often influence the non-renewal and expiry of franchise agreements. One example is retail leases, which are often outside the control of either the franchisors or franchisee: if a landlord refuses to renew a franchisee lease, the franchise agreement cannot continue. These issues cannot be dealt with by any reform of the Code.

6.4 Goodwill and restraint of trade

Existing approach

Two issues that often cause disputation at the conclusion of a franchise agreement are the treatment of goodwill and the imposition of restraint of trade clauses.

Goodwill is an intangible asset arising from the reputation of a business and its relations with its customers, distinct from the value of its stock.¹⁸¹ When a person or a firm buys another business, goodwill is the premium paid above the fair market value of all its assets, less liabilities.

The Code does not provide a franchisee any *automatic* entitlement to goodwill associated with the franchisee's business at the end of the term of a franchise agreement. However, it does require disclosure documentation to include details of the prospective franchisee's rights relating to any goodwill.

Restraint of trade clauses in franchise agreements prevent a franchisee from operating or working in a similar business for a specified time after the end of the franchise agreement. The Code does not prevent franchisors from including restraints of trade in franchise agreements. However, it does make them unenforceable in some circumstances if the franchisor has not compensated the franchisee for goodwill.

Because they can be harmful to competition, there are also other limits on the use of restraint of trade clauses. They are only enforceable under the common law if they are reasonable and proportionate. They may also be considered unfair contract terms under the provisions of the ACL.

¹⁸¹ Macquarie Dictionary, *goodwill*, Macquarie Dictionary website, 2023, accessed 8 November 2023.

What we heard

Most franchisee submissions raised the issue of goodwill. In those submissions, franchisees stated that they could not understand how their hard work, staff training, additional promotion of the brand (outside of the franchisor's marketing), and capital investments meant they had not created a degree of goodwill.

Some agreements specifically state that no matter how much risk the franchisee took, or how much of a business they built, they have no entitlement for compensation in relation to goodwill.¹⁸²

Several submissions noted the long history of this concern, which goes back as far as the 1976 Swanson Report and the 1979 Blunt Review.¹⁸³ Many franchisee submissions referenced the PJC's more recent considerations of goodwill, in its 2008 and 2019 inquiries.

The present situation where a franchisee's contribution to their business has a market value prior to the end of the agreement which can be arbitrarily reduced to an amount determined by the franchisor afterwards is inequitable. At the end of an agreement, a franchisee has already committed considerably to the franchise system, financially and through their hard work, and is financially tied to the business. Franchisees stand to lose the prospect of returns on their capital investment, which in many cases is substantial.¹⁸⁴

The recent Mercedes-Benz Case was a topical issue. Many franchisor stakeholders noted the decision appeared to be consistent with existing well-established legal principles, and cautioned against the potentially widespread ramifications and unintended consequences of deviating from those.

I see no substantive reason to change the established fundamental principles of common law with regard to proprietary rights of goodwill ... In the event that the government were to accept and legislate for a compensation payment for goodwill where an expiring franchise term (without options) was not renewed or there was a justifiable legitimate early termination for breach – the established precedents in property law definitions would be turned on its head and the unintended consequences for not only franchise contracts, but also Leases, Licences, and other commercial contracts involving proprietary rights would be significant.¹⁸⁵

Many franchisees expressed concern about restraints of trade in franchise agreements. Franchisees with professional and trade qualifications raised concerns that restraint of trade terms could limit them from practising their profession, even though they had achieved their qualification before entering a franchise agreement.

182 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 7.

183 Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs; Trade Practices Consultative Committee, Small Business and the Trade Practices Act*, Australian Government, December 1979.

184 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism*, p 80.

185 A Wein, *Response to 2023 Franchise Code Review – Consultation Paper*, p 8.

The Code should take a stronger stance with the ability of Franchisor's to apply restraint of trade provisions into their Franchise Agreements ... Franchisors should not have the ability to restrict ex-Franchisees from working in their industry for longer than a period of time the Franchisor needs to stabilise the Franchise, for example 3 months.¹⁸⁶

I understand that this [restraint of trade] is not really enforceable, however quite a few of my friends who have been put out of business did not have the funds to challenge this in court, which meant not only had they lost their savings and livelihood they also [lost] [sic] their ability to operate in a field they know.¹⁸⁷

Franchise sector advisors reported that the treatment of goodwill and restraint of trade in the Code by franchisors was satisfactory, particularly given the reasonableness tests which apply when attempting to enforce restraints of trade more generally.¹⁸⁸

Observations

Goodwill is often misunderstood. Whilst many franchisees believe that they may have a right to payment for the 'value added' that they have delivered to a franchise system, FDR data indicates that over 80% of franchise agreements explicitly exclude franchisee goodwill.

The absence of a legal right for a franchisee to be compensated for goodwill in franchising contracts has been well-established for decades. In the Mercedes-Benz Case, Justice Beach reiterated the legal precedent that:

... the absence of any right at law for a franchisee to be compensated for goodwill on non-renewal of a franchise agreement has long been recognised.¹⁸⁹

Clause 46A and 46B, which are currently limited in application to new vehicle dealerships, contain the principles that address the key issues underlying concerns with goodwill: compensation in the event of early termination (clause 46A), and the opportunity for a franchisee to make a return on their investment during the agreement (clause 46B). With appropriate modification, clause 46A and 46B could be extended to all regulated by the Code.

If a franchise agreement is terminated early by a franchisor, through no fault of the franchisee, it appears reasonable to provide some compensation.

Restraint of trade terms prevent a franchisee from setting up as a competitor to the franchise brand, often for a specified time and within geographic boundaries. Such conditions often attempt to prevent exiting franchisees from soliciting clients, suppliers, staff, and customers associated with the franchise brand.

186 S Peace and T Mukushi, *Submissions for review of the Franchising Code of Conduct*, Minerva Law, pp 2–3.

187 Anonymous franchisee (private and confidential submission), *Review of the Franchising Code of Conduct*.

188 See A Wein, *Response to 2023 Franchise Code Review – Consultation Paper*, p 8.

189 *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth & Westpoint Star Mercedes-Benz & Ors v Mercedes-Benz Australia/Pacific Pty Ltd* (2023) at 20 [125].

It was evident in some submissions that many franchisors and franchisees were not aware of the existing limitations and exemptions within the Code concerning restraint of trade. It appears that more promotion and education about trade restraint is required.

Legal advisors told the review they frequently encountered onerous, arguably non-enforceable, restraints of trade terms in franchise agreements. In particular circumstances, these may be addressed by unfair contract terms.¹⁹⁰

In August 2023, the Australian Government announced a Competition Review, which will examine competition laws, policies and institutions to ensure they remain fit-for-purpose for the modern economy. The Competition Review is best placed to examine the restraint of trade terms and other uncompetitive terms that may appear in franchise agreements.

6.5 Insolvency

Existing approach

Insolvency occurs when a company can no longer pay its debts when they are due. An administrator, receiver or liquidator will then be appointed to determine if the company can continue to trade, be restructured or sell the company's existing assets to pay creditors.¹⁹¹

Insolvencies pose special challenges for the franchising relationship due to the franchisees' dependency on the franchisor. The appointment of an administrator and interruption to 'business as usual' can impact a franchisee's ability to trade and effectively operate their business.

Insolvency laws are the responsibility of the Commonwealth and are primarily set out in the *Corporations Act 2001* (Cth) and supporting statutory instruments.¹⁹² These laws provide for an order of priority for the payment of employees and creditors in the context of insolvency and contain other prohibitions.

The Code contains no specific provisions relating to insolvency, although the potential for a franchisor to become insolvent is highlighted to franchisees in the Information Statement. Previous bankruptcies or insolvencies involving the management of the franchisor must also be noted in the disclosure document provided to franchisees.¹⁹³ Finally, the franchisor must provide an assurance of solvency as part of the disclosure document.¹⁹⁴

In September 2022, the Parliamentary Joint Committee on Corporations and Financial Services completed an examination into Australia's corporate insolvency laws, recommending that a comprehensive review of these be undertaken and that franchising insolvency issues should be considered as part of that review.¹⁹⁵

190 ACCC, *Back In Motion Physiotherapy Pty Ltd*, ACCC website, 18 September 2020, accessed 9 November 2023.

191 ASIC, *Insolvency*, ASIC website, 26 May 2023, accessed 3 November 2023.

192 See *Corporations Act 2001* (Cth), schedule 2.

193 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, annexure 1, item 4.

194 Ibid, schedule 1, annexure 1, item 21.

195 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate insolvency in Australia*, Australian Government, July 2023, p 252.

What we heard

Few submissions commented directly on insolvency in the context of franchising. Many submissions did, however, mention insolvency in the context of good faith, goodwill, dispute resolution and compensation. Most stakeholders appeared to understand that the *Corporations Act 2001* (Cth) sets out insolvency regulatory framework.

Some stakeholders called for changes to the law to provide greater protection for franchisees in the event of the franchisor's insolvency, arguing that:

Franchisees rely on a franchisor to behave ethically and competently, but unlike the avenue available to shareholders, franchisees can't sell their shares and reinvest in a different company. Nor can they quit their employment and look for another job. They are stuck at the mercy of their franchisor if the franchisor makes decisions detrimental to the franchisee or the system.¹⁹⁶

Stakeholders also noted that franchisees are not considered 'creditors' of the franchisor and are, therefore, not granted the same rights and protections as creditors under the *Corporations Act 2001* (Cth).

Other submissions argued that more information should be provided to prospective franchisees, which may help them mitigate their commercial risk when assessing a franchise. Submissions suggested that increased provision of bankruptcy information, franchise 'churn' data, and visibility of the franchisor's networks of corporations and trusts in disclosure documents would suffice. However, others noted that the Code already required this information.

Franchisor marketing funds were often linked to the issue of insolvency, with some franchisees submitting that those funds should be kept in trust should the franchisor become insolvent and enter administration.

To add salt to the wound, the marketing levy, as a contractual obligation, remains payable right through the period of administration until the franchise agreement is disclaimed by the liquidator. It is doubtful that franchisees receive any positive marketing value during the franchisor's administration.¹⁹⁷

In discussing franchisee insolvency, submissions from franchisees focused on the practices that drove them towards insolvency. Franchisees provided details of unilateral changes to the business model, supply chain lock-in and enrichment, change of ownership, misrepresentation in disclosure documents and franchisors creating barriers to exiting or selling their franchise.

Several stakeholders also raised the issue of ipso facto provisions, which permit the termination of an agreement based on an insolvency event. Emeritus Professor Buchan stated that:

¹⁹⁶ J Buchan, *2023 Franchise Regulation Review conducted for Australian Treasury by Dr Michael Schaper*, p 13.

¹⁹⁷ *Ibid*, p 10.

The Productivity Commission recommended these clauses be made void, arguing that they limit the prospect of an entity recovering from an insolvency event. Liquidators claims that they need access to the full suite of assets of a failing business so they can sell them to repay the creditors ... If franchisees had an ipso facto clause in their franchise agreement, they could sever contractual relationship/s with their franchisor, negotiate direct with suppliers and potentially continue to run a profitable independent business.¹⁹⁸

Other franchisee submissions made a variety of suggestions for reform, such as a potential franchisee right of first refusal on new ownership of the franchise; priority for acquisition of the franchise and assets by franchisees; and franchisor performance bonds, guarantees or insurance to provide compensation to franchisees in the event of insolvency.

However, submissions from some franchisors, industry bodies, regulators and professional advisors noted that the existing Code already provides for the provision of extensive financial information to prospective franchisees, and an expectation that they will seek professional advice before signing up to a franchise agreement. As such, franchisees might reasonably be expected to be aware of the consequences of a franchisor insolvency.

Observations

While concerns about franchisor insolvency are not widespread, the impact on franchisees can be significant. Franchisees do indeed face a degree of vulnerability when a franchisor becomes insolvent. The impact on franchisees will differ depending on the nature of the insolvency. For example, if an administrator is appointed, they may be able to continue to operate the franchisor business as a going concern and support the franchisee network accordingly. In other circumstances, the administrator may be unable to fulfil the franchisor's contractual obligations to franchisees.

Insolvency is a risk that permeates across the economy and all business-to-business transactions. The Code does not remove commercial risks in the ordinary course of business. It does, however, attempt to ensure that prospective franchisees are well aware of these risks before signing up to any agreement. Guidance and education material promulgated by government and industry associations should continue to highlight these risks and encourage franchisees to satisfy themselves as to the financial viability of the franchisor and the franchised business.

Other suggestions, including changes to insolvency laws and/or the *Corporations Act 2001* (Cth), are beyond the scope of the Code review. However, it is noted that the PJC recently recommended a comprehensive review of Australia's insolvency laws. If such a review is conducted, it may provide a further opportunity to consider the position of franchisees when a franchisor becomes insolvent.

198 J Buchan, 2023 *Franchise Regulation Review conducted for Australian Treasury by Dr Michael Schaper*, pp 10–11.

6.6 Findings and recommendations

Findings	
XVI.	Changes made in 2021 relating to delayed termination have made it unacceptably difficult for franchisors to act decisively in the context of serious breaches.
XVII.	There needs to be more awareness and clarity regarding the process and circumstances in which a franchisee can negotiate an early exit from a franchise agreement.
XVIII.	Misunderstanding of goodwill in franchising continues to be a source of complaints that arise at the end of an agreement. Goodwill issues are driven by concerns relating to adequate compensation, uncertainty, and the opportunity to make a return on investment.
XIX.	Unreasonable – and unenforceable – restraints of trade are unduly limiting franchisee opportunities at the end of a franchise relationship. While many existing restraints of trade terms may be difficult to enforce, they may unduly inhibit and dissuade competition in the sector.
Recommendations	Implementation suggestions
13. Provisions relating to termination for serious breaches should be simplified. Changes made in 2021 relating to termination under clause 29 of the Code should be revisited.	13A. The Australian Government should consult the sector when re-making the Code on options for simplifying these provisions without diminishing protection for franchisees. Options could include strengthening the rights of franchisors to terminate immediately if appropriate compensation is paid to a franchisee.
14. Best practice guidance should be provided to franchisees and franchisors regarding franchisee-initiated exit, to enhance the effectiveness of clause 26B of the Code.	14A. Guidance could take the form of resources produced in consultation with ACCC and ASBFEO regarding minimum standards and best practices. These resources could be housed on the proposed FranchiseSmart website.
15. Further work should be done to limit the use of unreasonable restraints of trade in franchise agreements.	15A. The Australian Government's Competition Taskforce should consider how to limit the use of restraints of trade and other uncompetitive terms in franchise agreements. 15B. The ACCC should issue guidance on when a restraint of trade may constitute an unfair contract term.

Chapter 7: Regulatory oversight and dispute resolution

Effective mechanisms for law enforcement and dispute resolution are a necessary corollary of a fit-for-purpose regulatory framework. This chapter examines a number of matters relating to compliance, enforcement, dispute resolution, and education, including:

- The role of the Australian Competition and Consumer Commission
- The role of the Australian Small Business and Family Enterprise Ombudsman
- Dispute resolution in the franchising sector
- Penalties in the Franchising Code
- Support for a licensing regime for franchisors.

7.1 The role of the Australian Competition and Consumer Commission

Existing approach

Although not explicit in the Code itself, the CCA makes it clear that the ACCC is the government authority with regulatory responsibility for the Code. The enforcement framework is largely set out in Part IVB and Part VI of the CCA and not the Code itself.

Individuals have a right of private action to seek remedies to compensate them for breaches of the Code, but the ACCC has a more expansive set of tools to respond to such matters.¹⁹⁹ The ACCC can:

- conduct compliance checks, requiring franchisors to provide copies of documents such as disclosure documents²⁰⁰
- seek court-enforceable undertakings from franchisors to address alleged breaches
- issue infringement notices to franchisors
- initiate court proceedings seeking civil penalties
- seek compensation on behalf of individuals.

The ACCC also has a major role to play in education, information dissemination and awareness raising amongst the franchising sector.

Since 2015 the ACCC has undertaken 15 public enforcement outcomes involving franchise systems. This has included the payment of infringement notices by 3 franchisors; accepting court-enforceable

¹⁹⁹ *Competition and Consumer Act 2010* (Cth), section 82.

²⁰⁰ *Ibid*, part IVB, division 5.

undertakings from five franchisors; and instituting court proceedings against 7 franchisors.²⁰¹ Since January 2015 the ACCC has also conducted 54 compliance checks for franchising using compulsory information notices. Finally, some matters are resolved administratively through direct engagement with a franchisor without the need to use formal enforcement powers.

The ACCC receives around 300 contacts per year in relation to franchising issues.²⁰² However, the ACCC is not resourced to pursue enforcement action in relation to every breach of the Code that it is aware of. Nor is it a dispute resolution body; this function is performed by ASBFEO. Ensuring that small businesses receive the protections of the competition and consumer laws, including the Code, has been an enduring enforcement priority for the ACCC,²⁰³ But given its limited resources, enforcement work is focused on the most significant matters.

The functions of the ACCC extend beyond enforcement in the strict sense and encompass the education and dissemination of information regarding the Code.²⁰⁴ The ACCC provides franchising information and education resources on its website, funds an online pre-entry program, and has a specialist external Small Business and Franchising Consultative Committee which meets regularly.

What we heard

In general, most stakeholders appeared to understand the role of the ACCC, its powers and limitations. Whilst the franchisee survey indicated that some 63% of respondents were aware of the ACCC's role in regulating the sector, it received only an average score of 3.9/10 when asked 'How effective do you think the ACCC is in regulating the franchise sector?'²⁰⁵

Concerns were expressed by some franchisee stakeholders about alleged widespread non-compliance with the Code, but little firm evidence was provided to the review to support these assertions. Franchisees in particular felt that there needed to be a more active approach from the ACCC. Many stakeholders acknowledged that the ACCC operates within a resource constrained environment, with some suggesting the ACCC requires further resourcing or dedicated personnel to pursue noncompliance in the franchising sector.

All sectors of the franchising industry, including small businesses, legal advisors, industry groups and government agencies, recognise that enforcement activity by the ACCC is necessarily limited by available resources.²⁰⁶

The ACCC indicated that it commits a disproportionately high level of resources to franchising enforcement and compliance, given that it also has a wide range of responsibilities in many other parts of the economy, and several other industry codes to also enforce. It noted that the complexity and *ex post* nature of the regulatory model limits its capacity to prevent harm effectively and rapidly. The ACCC considered that enforcement action, even where taken, often does not result in positive

²⁰¹ ACCC, *ACCC Submission*, p 22.

²⁰² *Ibid*, p 21.

²⁰³ See ACCC and Australian Energy Regulator (AER), *2023–24 Compliance and Enforcement Policy and Priorities*, ACCC and AER, March 2023, p 1.

²⁰⁴ *Competition and Consumer Act 2010* (Cth), section 28 describes the functions of the ACCC with respect to dissemination of information, law reform and research.

²⁰⁵ Appendix B (Franchisee survey) includes a more detailed breakdown of responses to this question.

²⁰⁶ ASBFEO, *Franchising Code Review Submission*, p 8.

outcomes for franchisees. In this respect, the ACCC was said to be ‘like an ambulance waiting at the bottom of a cliff’.²⁰⁷ The ACCC noted that most complaints received from franchisees sought a speedy resolution, whereas the court-based nature of its work typically required considerable time and effort to achieve resolutions.

The ACCC also noted that ‘even an amended Code cannot address or prevent the persistent harms that arise in franchising’ and suggested that oversight of the franchising sector could be better achieved through an *ex ante* regulatory regime.

Many stakeholders indicated that the ACCC’s information and education was comprehensive and useful to franchisees. However, a number of submissions were of the view that better communication and promotion of the Code and the ACCC’s education resources is required, with one industry group suggesting that many franchisees are not even aware of the Code.

Unfortunately the ACCC’s pre-entry franchise education program for potential franchisees is the best-kept secret in franchising. It is only passively promoted via reference in the Information Statement and the Code, and the ACCC website. In conjunction with the franchise sector, much more could be done to ensure that potential franchisees are aware of – and actually undertake – the program before they sign a franchise agreement.²⁰⁸

Several stakeholders suggested that the ACCC’s education could benefit from more information targeted at emerging new groups of franchisees (such as migrants and CALD groups), whilst others also suggested that many small-scale franchisors would also benefit from greater knowledge and access to training.

Observations

It is clear that the expectations of the sector with respect to enforcement of the Code exceed the current capacity of the ACCC. Since its inception in 1998, the mandatory Code has moved from being a light touch co-regulatory mechanism to a much more highly regulated, prescriptive one, and has placed much greater demands on the regulator.

The ACCC’s strong focus on education is consistent with best-practice modern regulatory approaches which recognise the value of helping parties voluntarily know their rights and responsibilities, and thus comply with the law. General poor awareness among franchisees of the ACCC’s role would tend to suggest there is merit in a more visible and active approach to education. The ACCC has discontinued the publication of statistics regarding its activities under the Code and has retired other resources such as the downloadable Franchisee Manual and Franchisor Manual in favour of web content. The ACCC continues to provide valuable information directly on its website and a free education program for prospective franchisees, although feedback suggests that better promotion of these useful resources is important.

One issue of concern to the review has been the atomisation of web-based information across many different sites. Franchisees today are faced with multiple online government-funded sources of franchising information, such as the ACCC website, business.gov.au, the Fair Work Ombudsman,

207 ACCC, *Small Business and Franchising Consultative Committee meeting*, 3 November 2023.

208 J Gehrke, *2023 Franchising Code of Conduct review*, p 4.

ASBFEO, and the Franchise Disclosure Registry. As recommended by the PIC in 2019, it may be now time to consolidate these into a ‘one-stop shop,’ similar in theory to the successful MoneySmart website run by ASIC (see Case study 3).²⁰⁹ This could effectively bring together the multiple sources of information into one platform. Such a comprehensive website could also act as host for the FDR, which is currently located on a separate government domain hosted by Treasury.

Case study 3: MoneySmart

MoneySmart is an Australian Government website launched in 2011 by ASIC. MoneySmart promotes informed participation by investors and consumers in the financial system.²¹⁰ The website provides independent, free, and reliable personalised money guidance tools, designed to engage people and lead to positive action.²¹¹ A key ASIC commitment under the then National Financial Literacy Strategy was to consolidate the two Government websites that had previously offered financial information, and which had significant overlapping material.²¹² The new MoneySmart website is now a nationally coordinated entry point for financial information and resources.²¹³ More than 9.7 million Australians visited MoneySmart between 1 July 2022 and 30 June 2023.²¹⁴

7.2 The role of the Australian Small Business and Family Enterprise Ombudsman

Existing approach

ASBFEO has two core functions. It is primarily an advocate for small business, providing advice to government and conducting research to improve the general operating environment for small business. A secondary role is to provide information and services to support businesses with dispute resolution.

Since 2021, ASBFEO has performed a range of functions set out in the *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* to help parties access ADR services.²¹⁵ ASBFEO’s role includes appointing persons to provide ADR services including voluntary arbitration, conciliation and mediation.

ASBFEO maintains a specialist panel of ADR practitioners across each state and territory. All practitioners are accredited under the National Mediator Accreditation Standards system. Whilst the majority of the practitioners are practising lawyers, they are not able to provide legal advice as part of the ADR process.

209 ASIC, *moneysmart.gov.au*, money smart website, n.d, accessed 8 November 2023.

210 ASIC, *About us*, money smart website, n.d, accessed 8 November 2023.

211 ASIC, *National financial literacy strategy*, report number 229, ASIC, March 2011 p 7.

212 Ibid, p 32–33.

213 Ibid, p 33.

214 See ASIC, *Media centre*, money smart website, n.d, accessed 8 November 2023.

215 See *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), clause 4A.

Recent statistics published by the ASBFEO in relation to its mediation services and dispute resolution support function indicate that in the 12 months up to 30 June 2023, the Ombudsman's office provided active case management for over 150 franchising disputes.²¹⁶

In discussing the role of ASBFEO, it is important to note the complementary role played by small business commissioners in many states including Victoria, New South Wales, Queensland, South Australia and Western Australia. State based commissioners can also support franchise sector participants to access ADR, either through their own services or by referring a complainant to ASBFEO.

What we heard

In the franchisee survey commissioned for this review, general awareness of the mandatory dispute resolution framework administered by ASBFEO was moderately high, with around 50% of franchisees indicating that they were aware of this service.²¹⁷

Among those stakeholders who had interacted with ASBFEO, overall feedback indicated general satisfaction with the dispute resolution services provided.

The ASBFEO's role and activity in supporting dispute resolution has been highly effective in terms of improving the timeliness and appropriateness of the resolution of disputes.²¹⁸

... the Ombudsman does an excellent job and promotes his role and function of ASBFEO well.²¹⁹

Some respondents, however, indicated they still preferred to use private mediators rather than utilising ASBFEO's services.

Some franchisees suggested that the role of ASBFEO should be expanded, with ASBFEO granted powers akin to the ACCC's enforcement powers so they could play a supporting role in regulating the sector.

ASBFEO noted the government's commitment to introducing designated complainant laws which will empower consumer and small business advocates to raise systemic complaints with the ACCC, and which will come into effect from July 2024 onwards. Noting that designated complainants will be nominated by the government, ASBFEO considered that it may be appropriate for it to be a designated complainant.²²⁰

ASBFEO also suggested that a program similar to its Small Business Tax Concierge (SBTC) service be introduced, which could support franchisees by providing them with subsidised preliminary legal advice.²²¹

216 ASBFEO, *Ombudsman welcomes franchising review and appointment of reviewer* [media release], ASBFEO, 15 August 2023.

217 Appendix B (Franchisee survey) includes detailed results of the survey.

218 Law Council of Australia, *Review of the Franchising Code of Conduct*, p 12.

219 D Sutherland, *Submission to the Franchising Review*, p 26.

220 ASBFEO, *Franchising Code Review Submission*, p 10.

221 Ibid, pp 10–11. *Note:* the SBTC service provides eligible small businesses with up to two hours of subsidised legal advice from an independent third party before they decide whether to appeal an ATO decision to the Administrative Appeals Tribunal.

Observations

ASBFEO's role in the dispute resolution system is generally well supported by stakeholders across the spectrum. Whilst some suggestions were made that ASBFEO should take on a more quasi-regulatory role, this would sit uncomfortably with its statutory functions as an advocate for small and family businesses. The ACCC is better placed than ASBFEO to ensure compliance with the law through its existing investigative powers and regulatory authority.

ASBFEO noted that the designated complainant measure would provide it with the capacity to formally escalate complaints about serious breaches of the Code for enforcement action. It is understood that the Government will release further details on the implementation of this measure over the coming months. An appropriate role for franchise interests should be considered.

There is merit in establishing a concierge service, similar to the SBTC service, to help franchisees in dispute with their franchisor to understand their legal position and prepare for ADR. Ultimately, such a measure could increase the likelihood of more matters being resolved by ADR and without the need for legal action.

There is scope for ASBFEO to also play a more active education role, especially on issues that might typically be regarded as beyond the regulatory remit of the ACCC. For example, there would appear to be scope for ASBFEO to work with sector participants to build a shared understanding of best practice on issues such as change management, the use of marketing funds and voluntary arbitration.

Finally, it may be appropriate to consider whether there should be a more joined-up approach to the dissemination of information, through ASBFEO's participation in a possible 'FranchiseSmart' website.

7.3 Dispute resolution

Existing approach

Effective mechanisms for dispute resolution are a necessary corollary of an effective legal or regulatory framework. One option is for aggrieved parties to seek formal court-based resolution. However, taking action through the courts is a generally a costly and time-consuming process.²²²

Recognising that court proceedings are likely to be an impractical option for the vast majority of disputes that arise in franchising, the Code contains a mandatory dispute resolution process which provides that, if parties are unable to resolve a dispute through mutual negotiation, either party may refer the matter to an ADR process. The Code makes it mandatory for the parties to participate in ADR and genuinely try to resolve the dispute in good faith.

222 According to estimates by the Australian Government Attorney-General's Department (AGD) in 2009, the average cost of going to the Federal Court was \$111,130 (including fees and disbursements). See AGD, *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, report by the Access to Justice Taskforce Australian Government, AGD, Australian Government, 1 September 2009, p 41. Factoring in an average inflation rate of 2.4% per year, the cost is more likely to be around \$151,000 in 2023.

An ADR process under the Code means conciliation or mediation, and the parties must share the cost associated with this. During mediation and conciliation, the practitioner provides the framework for the discussion and facilitates the circumstances to move it forward so that each party can understand the other's point of view. Under a strict approach to mediation, the practitioner generally avoids offering suggestions or recommendations to either party about ways to resolve the dispute. In contrast, an ADR provider employing a conciliation style approach may make suggestions for terms of settlement, give expert advice on likely settlement terms, and may actively encourage the participants to reach an agreement.

Since 2021, the Code has also provided a mechanism for the parties to engage in binding arbitration if they both agree beforehand (known as 'voluntary binding arbitration'). Arbitration is a more formal process than mediation and conciliation, where the parties present their case to an independent person – an arbitrator – who decides how to resolve the dispute. Because arbitration under the Code is voluntary, this is only an option if the franchisee and franchisor have agreed in writing to resolve a dispute this way.

Another change introduced in 2021 was the provision in the Code for multi-party ADR. Recognising that many franchisees may often have similar disputes with the same franchisor, an option to access one ADR process was introduced into the Code.

The potential for voluntary arbitration to provide an alternative and more effective framework for dispute resolution has also been explored privately by a number of industries. One example is the automotive sector. In 2022 the Australian Automotive Dealers Association (AADA), the Motor Trades Association of Australia (MTAA) and the Federal Chamber of Automotive Industries (FCAI) signed a memorandum of understanding that committed them to promote the use of voluntary binding arbitration through the inclusion in dealership agreements of clauses that commit the parties to arbitrate certain disputes that may arise.

What we heard

Mixed views were expressed by stakeholders on the effectiveness of current dispute resolution mechanisms. While all parties tended to agree that mandatory participation in ADR was important, issues regarding awareness and cost were raised. Stakeholders also differed in their views on whether the current frameworks were sufficient, or if a further mechanism was needed to deliver binding outcomes in a timelier matter.

I do believe that there needs to be a greater awareness and of mediation, and it should be used far more often than it is. To this effect, the Code could be amended [so] that every Breach and/or and Termination notice could include a concurrent invitation to mediate the issues at hand. This would be an important early circuit breaker in the escalation of disputes between the parties as typically mediation would only occur AFTER a breach or termination notice has been issued, and then only at the specific request of one of the parties (usually the franchisee).²²³

Stakeholders also suggested that more information and guidance could be provided to help parties better understand arbitration, particularly the voluntary arbitration mechanisms in the Code.

223 J Gerhke, 2023 *Franchising Code of Conduct review*, p 5.

ASBFEO suggested that the FDR could be utilised to help increase the uptake of voluntary binding arbitration and that franchisors could:

... self-elect willingness to use VBA and [indicate] what type of disputes they would be willing to resolve by VBA by making an appropriate disclosure in pre-entry documents, as well as on the FDR. This would allow franchise systems to demonstrate their willingness to resolve disputes in their system in a timely and cost-effective way. Early adopters could also benefit as they distinguish their systems in this way.²²⁴

Stakeholders noted significant discrepancies in the cost of seeking ADR through ASBFEO and other providers (such as the small business commissioners), with one stakeholder highlighting the importance of minimising costs for franchisees.

A central objective for dispute resolution should be to keep costs to franchisees to a minimum. We have received feedback that the ASBFEO is considered expensive ... ²²⁵

ASBFEO submitted that parties could be provided with subsidised access to ADR processes coordinated by ASBFEO.

ASBFEO also noted in its submission that while franchisors may comply with the Code by agreeing to attend ADR, there is an increasing incidence of franchisors not attending the arranged ADR or attending ADR but not following through on the agreed outcomes. In these situations, the only option left for the franchisee is to take legal action, which they often cannot afford.

ASBFEO suggested that a provision in the Code allowing it to publicise non-attendance at ADR would strengthen its ability to address non-attendance and any unwillingness to implement mediated resolutions, noting that equivalent so-called 'call out' powers already exist under the *Australian Small Business and Family Enterprise Ombudsman Act 2015* (Cth).²²⁶

By adding a call-out power, agencies assisting with disputes under the Franchising Code, and in particular the ASBFEO, could publicise non-attendance at ADR, failure to act in good faith at ADR, an unwillingness to implement mediated resolutions and any general lack of good faith, or similar compliance issue.²²⁷

While submissions generally agreed that the introduction of voluntary binding arbitration in 2021 was a positive development, some stakeholders noted that the voluntary binding arbitration function had not been well utilised to date.

[S]ince its introduction, there have been no appointments of an arbitrator by the ASBFEO under the Franchising Code, nor are we aware of any agreed VBA engagements external to our Office. This is despite the ASBFEO supporting parties in disputes to seek agreement of other parties to arbitrate.²²⁸

224 ASBFEO, *Franchising Code Review Submission*, p 9.

225 7-Eleven, *7-Eleven Submission to the Review of the Franchising Code of Conduct Consultation paper*, p 8.

226 See the *Australian Small Business and Family Enterprise Ombudsman Act 2015* (Cth), section 74.

227 ASBFEO, *Franchising Code Review Submission*, p 9.

228 ASBFEO, *Franchising Code Review Submission*, p 9.

Other respondents reported that obtaining mutual consent to arbitrate a dispute is difficult, and there is usually little incentive for a franchisor to voluntarily submit to arbitration. The AAF submitted that the ‘availability of a compulsory arbitration step would greatly encourage recalcitrant franchisors to engage more constructively at mediation or conciliation.’²²⁹ The Law Council of Australia’s SME Law Committee also advocated for mandatory arbitration of franchise disputes which cannot be resolved through mediation or conciliation.²³⁰

However, the SME Law Committee did highlight the constitutional limitations on implementing mandatory arbitration. They cited the Australian Financial Complaints Authority (AFCA) model as a potential alternative framework for introducing mandatory arbitration into the Code.

Some stakeholders also commented on the costs and inaccessibility of formal justice through the courts. One example provided was the Federal Court requiring security for costs for litigants. The power to order an applicant to provide a security for costs is contained in the *Federal Court Act 1976* (Cth) and provides that the amount, timing, manner and form of the security are to be directed by the Judge or Court.²³¹ If such an order is successful the applicant’s proceedings must be stayed until the payment is made, and if they fail to comply the proceedings may be dismissed.²³² Stakeholders explained that franchisees had been required to provide security for costs in a number of cases.

[i]n cases where the ACCC declines to take enforcement action, the availability of class actions / representative proceedings has been substantially impeded by the practice of the Federal Court to require security for costs, invoking the principle that, where an action is brought for the benefit of others, security ought to be provided.²³³

In its submission the Law Council recommend that the ‘no adverse costs’ provisions in the CCA should be extended to parties bringing an action in relation to the Code.²³⁴

Other parties such as ASBFEO went further and suggested court reforms to improve the capacity of small businesses to take private action.

Introducing a Federal Small Business and Codes List into the Federal Family and Circuit Court of Australia would provide a low-cost alternative for small businesses and regulators to seek redress and cost-effective and timely enforcement action. Disputes appearing on the list would be capped at \$1 million (award or fine) and delivered via online hearings, significantly reducing the time and cost burden on a small business.²³⁵

229 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 5.

230 Law Council of Australia, *Review of the Franchising Code of Conduct*, p 13.

231 *Federal Court Act 1976* (Cth), section 56.

232 Federal Court Rules 2011, r 19.01.

233 Law Council of Australia, *Review of the Franchising Code of Conduct*, p 14.

234 Ibid, pp 14–15

235 ASBFEO, *Franchising Code Review Submission*, p 12.

Observations

Access to justice through an efficient and effective civil dispute resolution process is necessary to support effective working relationships in the franchisor sector. At its best, effective dispute resolution allows parties to work constructively to resolve their differences quickly and at minimal cost, allowing the relationship to recover.

Compared to the large expense that a full litigation process may cost, ADR is a cost-effective dispute resolution option for franchisees and franchisors, particularly where parties are seeking to maintain their commercial relationship. Undertaking legal action can significantly damage the relationship between two parties, take considerable time from the commencement of legal proceedings to reaching an outcome, and is often beyond the financial means of one or both parties.

Formal litigation can also impact on the reputation of the entire franchise system, noting that while ADR is a confidential process between parties to resolve a dispute, matters heard in court are on the public record.

However, franchisees are vulnerable when franchisors do not meaningfully participate in ADR. Call out powers under the *Australian Small Business and Family Enterprise Ombudsman Act 2015* (Cth) are an effective way to publicise any nonattendance, and including a power of this kind for ASBFEO in relation to the Code may help reduce the level of non-participation.

There appear to be different views on why voluntary arbitration under the code has not been used, noting there have not been any appointments of an arbitrator made by ASBFEO or external to the ASBFEO. This potentially leaves a gap in the dispute resolution model. In the first instance, efforts to improve uptake of these provisions through education and the development of best practice guides should be considered.

The lack of success of the voluntary binding arbitration mechanisms to date may point to the need for government to consider alternative solutions to achieve speedy and cost-effective resolution of disputes in the sector. However, the current Code cannot be amended to provide for the mandatory arbitration of disputes. As such, it is worth considering the utility of an *ex ante* regulatory scheme to deliver binding dispute resolution in a cost-effective manner. This is further considered below.

There is also merit in improving the capacity of franchisees to pursue formal action through the court system. Given that one of the most pressing issues is the cost of litigation, the existing 'no adverse costs' provisions in the CCA could be expanded in scope so that parties seeking redress against a franchisor under the Code or the ACL can utilise such tools. There is little downside risk to this approach, since the court retains the flexibility and discretion to make orders as it sees fit in each application.

7.4 Penalties in the Code

Existing approach

Penalties were first introduced to a select number of obligations in 2015 following the Wein Review, which noted that there needed to be a deterrent for unethical and opportunistic behaviour that was proportionate to the seriousness of the conduct.²³⁶ However, these only applied to a limited number of Code breaches, and were set relatively low.

In 2019, the PJC suggested increasing penalties to ensure meaningful deterrence for breaches, arguing that the penalty regime lacked consequences and was not achieving its purpose.²³⁷

Following this recommendation, the CCA was amended to impose a higher ceiling for a breach of a civil penalty provision. In March 2022 the number of penalty provisions in the Code was increased and the penalty ceiling that could be imposed by the courts was increased from 300 to 600 penalty units (in current values, from \$93,900 to \$187,800).

In addition to this, a small number of provisions were amended to prescribe a higher penalty. These are shown in Table 6 below. For these specified breaches of the code, a contravention by a body corporate attracts a penalty of the greatest of \$10 million; 3 times the value of the benefit obtained from the contravention (if the court can determine the value); or 10% of the annual turnover of the body corporate during the 12-month period in which the act or omission occurred or started to occur (if the court cannot determine the value of the benefit obtained from the contravention).²³⁸

Table 6: Provisions attracting the higher penalty ceiling in the Code

Provision	Explanation
Subclauses 17(1) and (2)	The obligation for franchisors to disclose certain materially relevant facts.
Clause 33	The requirement for franchisors to not restrict or impair the freedom of franchisees or prospective franchisees from an association or associate for a lawful purpose.
Subclauses 46A(1), (2) and (3)	The requirements for new vehicle dealership agreement to contain clauses providing for the compensation of the franchisee if certain circumstances arise.
Clause 46B	The requirement for franchisors not to enter into a new vehicle dealership agreement unless the agreement provides the franchisee with a reasonable opportunity to make a return on investment during the period of the agreement.

Infringement notices

Infringement notices can be issued by the ACCC if there are reasonable grounds to believe that a party has contravened a civil penalty provision of an industry code.²³⁹ If the infringement notice is paid, no further court enforcement action is pursued. This is an alternate mechanism that allows for faster enforcement without the ACCC needing to commence court proceedings.²⁴⁰

²³⁶ A Wein, *Review of the Franchising Code of Conduct*, p 128 and 151.

²³⁷ Parliamentary Joint Committee on Corporations and Financial Services, *Fairness in Franchising*, p 225.

²³⁸ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), schedule 1, clause 5A.

²³⁹ *Ibid*, section 51ACD.

²⁴⁰ *Ibid*, section 51ACC.

Infringement notices carry a penalty of 50 penalty units (or \$15,650) for a body corporate.²⁴¹ Payment of an infringement notice does not constitute an admission by the franchisor that they have breached the Code.²⁴²

What we heard

Stakeholders generally appear to support the penalty regime, understanding that penalties are an important mechanism to deter non-compliance with the Code.

There was also some feedback that the 2022 changes to increase penalty ceilings had brought about a better culture of compliance within the sector.

Some stakeholders argued that penalty provisions should be drafted as ‘black letter law’ so as to clarify what behaviour exactly constitutes a breach of a provision.

The ACCC raised concerns about its ability to enforce obligations contained in the Code where the provision does not attract a penalty.

The lack of any sanction for breaching certain parts of the Code undermines our ability to ensure compliance with the Code.²⁴³

An example of this issue is clause 19, which requires franchisors to keep copies of certain documents for 6 years. However, there is currently no penalty for failure to do so. The ACCC has argued that in order to effectively conduct its audit and enforcement functions under section 51ADD of the CCA, penalties should exist for a breach of clause 19.

However, some stakeholders in the automotive industry opposed an increase in penalties, suggesting that an overly high level of penalties would lead more firms to cease using franchising as their business model.

Several other stakeholders suggested the creation of a two-tier penalty system that could differentiate between large and smaller franchisors.

Very few stakeholders had opinions on the ACCC’s infringement notice power, although some did support the use of infringement notices as a faster mechanism to address misbehaviour in the sector.

Infringement notices can provide a timely and cost-effective way of resolving concerns that achieves general and specific deterrence without costly and protracted legal proceedings. [...] We consider that the infringement notice penalties available for an alleged breach of an industry code are too low to motivate compliance and should be brought into line with those available for alleged false or misleading representations and alleged unconscionable conduct.²⁴⁴

241 *Competition and Consumer (Industry Codes—Franchising) Regulation 2014* (Cth), section 51ACF.

242 *Ibid*, subsection 51ACG(2).

243 ACCC, *ACCC Submission*, p 12.

244 *Ibid*, p 12.

Observations

The review received significant (but not universal) feedback that the monetary value of penalties should be reassessed. However, parties disagreed as to exactly what final quantum such penalties should take. This is not unexpected, as penalties will always be a contentious area of discussion in any regulatory regime.

A regulatory framework in which only selective breaches attract penalties is problematic. Some offences can incur meaningful penalties, but other behaviour which might be equally damaging can escape sanction. This is an unsatisfactory arrangement. The review recommends that the Code should be remade with all substantive obligations having a penalty provision. This would ensure enforcement is consistent across the entire Code. The review also recommends increasing the value of infringement notice penalties to improve deterrence.

7.5 Support for a licensing regime

Existing approach

The review heard a number of suggestions that government should consider adopting an *ex ante* licensing based regulatory system. This was put forward as a mechanism to deal with many of the current shortfalls in the Australian regulatory model. Most significantly, it has been advocated by the existing regulator of the Code, the ACCC.

The current franchising regulatory framework can be characterised as an *ex post* regulatory model. Regulatory enforcement takes place after a suspected breach has occurred; there is no pre-emptive management of problematic issues. The Code seeks to regulate participation in franchising but does not prohibit or monitor the behaviour of participants unless and until allegations of suspected misconduct occur. Enforcement and dispute resolution mechanisms are available but generally are only used after misconduct has occurred and harm has been suffered. The time and cost associated with court proceedings, and the financial position of the franchisor, limit the capacity for formal redress.

This is not the only manner in which franchising can be regulated. Several industries operate under an *ex ante* regulatory regime in which a government authority must provide approval (or a licence) for an entity to conduct business. An Australian example is the financial services sector (see Case study 4 below). *Ex ante* franchise regulation is also found in some other jurisdictions such as Malaysia, China, Indonesia and South Korea. Many individual states in the USA also operate *ex ante* regulatory regimes.²⁴⁵

245 DLA Piper, *Global Overview of Specific Franchise Statutes and Regulations*, Lexology website, 16 March 2023, accessed 20 November 2023.

Case study 4: Financial services licensing and dispute resolution

In order to conduct a financial services business within Australia, parties must have an Australian Financial Services Licence (AFSL). AFSL holders have a general obligation to provide efficient, honest and fair financial services complying with the conditions of the AFSL and the obligations contained in the *Corporations Act 2001* (Cth).²⁴⁶ Holding the licence does not guarantee the probity or quality of the licensee's services.

Subsection 912A(2) of the *Corporations Act 2001* (Cth) provides general obligations of licensees regarding dispute resolutions systems. AFSL holders are required to be members of the AFCA scheme.²⁴⁷

AFCA is an independent body which administers a dispute resolution scheme for the financial services sector. It provides dispute resolution as an alternative to court proceedings, assisting consumers and small businesses to reach agreements with financial firms about how to resolve their complaints. AFCA is not a government department or agency and is not a regulator; it is impartial and independent. The AFCA board is made up of 4 directors with consumer and 4 with industry experience and is overseen by an independent chair. If accepted by a complainant, a determination made by AFCA is binding on the financial firm involved in the complaint.²⁴⁸

AFCA services are free to consumers and small businesses who make complaints. The scheme is funded by annual member registration fees, user charges and complaint fees received from member financial firms. As it is a requirement by law to be a member, licensees must pay a registration fee (\$375 for financial firm members in 2022–23 FY).²⁴⁹ If AFCA receive a complaint against a firm, the firm is required to pay an individual complaint fee. To encourage early resolution of complaints the fee schedule ties complaint fees to stages of the resolution process and allows for fast-track decisions.²⁵⁰ AFCA will try to resolve a complaint by informal methods and reach a settlement by negotiation or conciliation first. If the matter requires a formal determination, there are a number of outcomes and remedies available. If a decision is made that is in the complainants' favour and is accepted by the complainant, licence holders must comply with the terms of the decision, or they will be reported to ASIC. If the complainant chooses to not accept the determination, they can pursue their claim through the courts.²⁵¹

The complaint is determined by an Ombudsman, an Adjudicator or an AFCA Panel. In appointing the decision-maker, consideration is given to efficiency, complexity of the complaint, value of the loss, potential systemic issues, or new unadjudicated issues as well as the expertise and experience level required of the decision maker.²⁵²

The AFCA system has been an effective method for delivering ADR and reducing the workload of regulators, with 76% of complaints resolved by agreement or in favour of complainant in the 2022–2023 financial year. Of 96,987 complaints received in the 2022–2023 financial year, 86,185 were closed within an average of 69 days, and a total of \$253 million in compensation was paid to consumers.²⁵³

246 *Corporations Act 2001* (Cth), section 912A.

247 *Ibid*, subsection 912A(2).

248 Australian Financial Complaints Authority (AFCA), *Corporate information*, AFCA website, n.d, accessed 8 November 2023.

249 AFCA, *2022–23 Annual Review*, AFCA, Australian Government, October 2023, p 30.

250 AFCA, *2022–23 Annual Review*, p 31.

251 AFCA, *The process we follow*, AFCA website, n.d., accessed 8 November 2023.

252 AFCA, *Decision Makers*, AFCA website, n.d., accessed 8 November 2023.

253 AFCA, *2022–23 Annual Review*, p 4.

What we heard

Some stakeholders commented directly on the potential of a licensing regime. Other respondents commented on the desirability of certain regulatory reforms which could be more effectively achieved through a licensing or *ex ante* regime than the existing approach under the Code.

As noted above, the ACCC advised the review that, based on its lengthy experience in enforcing the Code, it had formed the view that an *ex ante* system might be needed to better address enduring problems in the sector. It advocated the adoption of a licensing system, in which franchisors would need to obtain approval to operate a franchise system, and in which ongoing approval to operate would be conditional on compliance with a number of licensing requirements. Other support for this approach was evident among franchisees and their representatives.

We need to regulate who can call themselves a “Franchise.” This is the real threat. Many of the bad ... come from fledgling operators who use the term “franchise” to attract people into their business well before they have proven the model.²⁵⁴

The AAF also noted its position that franchisors should be licensed, and that a ‘compulsory condition for franchisors to obtain a licence, should be their agreement to participate in compulsory arbitration if required’.²⁵⁵ Like the ACCC, the AAF considered that the Code has ‘outlived its usefulness’. It argued that ‘[t]he sector does not need more regulation, but it does need a different regulatory mindset’.²⁵⁶

Some stakeholders pointed to the potential for the FDR to act as the basis of a licensing scheme.

The Disclosure Register could also be used as a form of control of over non-compliant franchisors, such that any franchisor who does not meet the criteria to register, or who is suspended or removed from the Register is effectively barred from granting further franchises ...²⁵⁷

Some stakeholders noted that there are currently no restrictions on who may offer a franchise opportunity. They pointed out that although a commonly held tenet of franchising is that it is a ‘proven business concept’, a franchisor does not have to have operated a business successfully, or for any particular period of time, before they start entering into franchise agreements with franchisees. Individuals offering franchises do not need to have any minimum qualifications or experience, and do not need to have any degree of financial security in the form of working capital or other means to support the operation of the business. These stakeholders suggested that a licensing system might be able to deal with these perceived weaknesses, by imposing minimum conditions on franchisors.

Most stakeholders agreed that, while the idea of shifting to an *ex ante* or licensing regime may have merit, the idea required significant further explanation and exploration to fully understand the potential impacts of such a significant change to the regulatory model for franchising.

254 *Franchisee survey* [data set], October 2023, accessed 21 October 2023 (see Appendix B for more details).

255 AAF, *Submission on behalf of the Australian Association of Franchisees*, p 5.

256 *Ibid*, p 11.

257 J Gehrke, *2023 Franchising Code of Conduct review*, p 3.

Observations

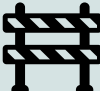
There is emerging discussion among the sector regarding the need for a more fundamental shift in the regulatory approach, which would see the current Code adapted or replaced to provide a form of ‘*ex ante*’ regulation in the form of a licensing regime for franchisors.

There are several ways in which such a scheme might operate. If licensing with an AFCA-style dispute resolution body is adopted, then the licensing function might be outsourced to a new independent entity which is jointly run by franchisees and franchisors, and in which franchisors will be expected to pay fees. Membership of the entity will be a prerequisite to obtain a licence to operate a franchise system in Australia. ADR and education functions might be run by this entity, which would also have the ability to sanction breaches of the Code, deal directly with complaints, and address systemic issues as they emerge. The role of the ACCC might therefore be limited to prosecuting the most serious breaches, and only after the licensing entity has been unable to satisfactorily resolve an issue. Other variations to this hypothetical model are also possible.

The potential benefits of a licensing regime might include sector ownership of problems and dispute resolution mechanisms; the ability to sanction breaches more effectively and quickly by either franchisors or franchisees through a more nuanced penalty and infringement notice regime; sector oversight of education and information dissemination; and the development of a holistic approach to problems in the sector. However, there are also some potential drawbacks to such a scheme. These include adjustment to a new regulatory model, annual fees for franchisors to fund the scheme, and the possible impact on competition and innovation with increasing barriers to entry.

Based on the feedback and analysis conducted as part of this review, there is prospective merit in this shift. An *ex ante* licensing regime may provide a more efficient and effective way to address persistent issues in the sector, without necessarily imposing a greater degree of complexity or regulatory burden than the current Code.

However, a comprehensive analysis is needed to understand the nature, extent and implications of such a fundamental shift. Further work is needed to evaluate the merit and feasibility of any proposal. Consideration should also be given to leveraging the FDR infrastructure and obligations to support any move from registration to formal licensing.

 Tool 1	 Tool 2	 Tool 3
Rules about who can hold a franchise licence	Powers for the licensing scheme to prevent harm or penalise breaches	Framework for binding dispute resolution
Rules could be imposed about who could be a franchisor. Licences could be tailored to allow for ‘right sized’ regulation – for example, to prevent new franchisors from expanding too quickly. Requirements may cover: • Fit and proper person standards (experience, qualifications, criminal or bankruptcy history) • Working capital requirements/demonstrated profitability of the franchise model • Capacity to manage conflicts of interest (for example, supplier rebates) • Continuing professional development	The licensing scheme operator could refuse to grant a licence, place conditions on a licence, suspend or revoke a licence. Such decisions could be made administratively, without the need to pursue court proceedings.	As a condition of being granted a licence, franchisors could be required to agree to submit to binding external dispute resolution.
Potential benefits	Potential benefits	Potential benefits
• Increase in the standard of management and quality of franchise offerings • Enhanced confidence in sector • More efficient allocation of resources (franchisee investment) to higher quality franchise offerings • Reduces burden on franchisees to perform checks on franchisors	• May provide a more efficient mechanism to ensure compliance • Reduces the potential for enforcement to result in the insolvency of the franchisor • More flexible evidentiary requirements	• Address ongoing concerns about the need for binding external dispute resolution in the franchising sector • Would complement the role of the ACCC in pursuing egregious and systematic wrongdoing by ensuring cost effective recourse is available for all breaches of the law • Where patterns of problematic conduct emerge matters could be escalated to the ACCC for enforcement (including possible licensing restrictions)
Potential risks	Potential risks	Potential risks
• Impacts on innovation/competition • Franchisees may underestimate risk due to government oversight • May make the sale of franchise systems more difficult	• Would need to address concern that it may make it more difficult for incumbent franchisees to sell their business, or renew their franchise arrangements, if the franchisor is operating without a licence to grant new franchise agreements	• Mediation resolution rates may decline if parties opt for binding arbitration instead • The complexity of disputes in franchising could make it difficult to achieve the ambition of timely and cost-effective outcomes
Examples	Examples	Examples
• Australian financial services licensees²⁵⁸ • Credit licensees²⁵⁹ • Registration of tax practitioners²⁶⁰		• Australian Financial Complaints Authority • Telecommunications Industry Ombudsman • Energy and Water Ombudsman (several states)

258 See ASIC, *AFS licence applications: Providing information for fit and proper people and certain authorisations*, ASIC website, n.d., accessed 8 November 2023

259 See ASIC, *Fit and proper people*, ASIC website, n.d., accessed 8 November 2023.

260 See Tax Practitioners Board (TPB), *Fit and proper requirements*, TBP website, 9 February 2023, accessed 8 November 2023.

7.6 Findings and recommendations

Findings	
XX.	The existing approach to online education and advice resources for the franchising sector is not optimal. The spread of resources across the ACCC, ASBFEO, business.gov.au and Treasury websites increases search costs for participants in the sector and decreases the chance that the resources will be utilised.
XXI.	The needs of indigenous and CALD communities are not currently well considered in education and outreach.
XXII.	Franchisees would benefit from greater access to early advice on the merits of their claim against a franchisor. ASBFEO's existing Small Business Tax Concierge Service provides a useful model as to how this might work.
XXIII.	Powers for ASBFEO to name franchisors who have not meaningfully participated in dispute resolution mechanisms can be a useful tool.
XXIV.	Code compliance would be enhanced by increasing both the number of penalty provisions and the capacity to issue infringement notices.
XXV.	While the current Code remains fit for purpose, it would be beneficial to examine the merits and feasibility of a shift to an ex ante licensing regime prior to the next review of the Code.
Recommendations	Implementation suggestions
16.	A comprehensive online government resource should be created, in the nature of ASIC's MoneySmart website ('FranchiseSmart website').
17.	Australian Government agencies should work with relevant sector participants to improve standards of conduct in franchising by developing best practice guidance and education.
18.	ASBFEO should be given additional powers to name franchisors who have not participated meaningfully in alternative dispute resolution.
19.	The Australian Government should assist franchisees to access low-cost legal advice on prospects prior to formal ADR.
20.	The Australian Government should consider an appropriate role for franchise interests when implementing its commitment to a designated complaints function for the ACCC.
21.	Franchisees should be able to seek a 'no adverse costs' order when bringing a matter against a franchisor for breach of the Code or the Australian Consumer Law.
16A.	Primary responsibility for this site could rest with the principal regulator, the ACCC. The ACCC could work with content creators for business.gov.au, ASBFEO and other relevant government agencies to collate relevant information in a user-friendly manner.
16B.	Special regard should be made to the needs of CALD and First Nations audiences.
17A.	Best practice guides could be developed by ASBFEO and the ACCC and other agencies as relevant. Guides could be housed on the proposed FranchiseSmart website.
17B.	Initial matters for best practice guidance could include change management, the operation of marketing funds, supporting franchisees who wish to exit, and how to effectively participate in voluntary arbitration and multi-party dispute resolution.
17C.	Such guidance and education should ensure that the franchising sector is adequately informed about the impact of the new UCT provisions and any new unfair trading practice laws.
18A.	ASBFEO's functions under the regulations that prescribe the Code could be expanded to include adverse publicity powers similar to those under section 74 of the <i>Australian Small Business and Family Enterprise Ombudsman Act 2015</i> (Cth).
19A.	ASBFEO's Small Business Tax Concierge function could be renamed and expanded to allow franchisees to access low-cost advice on their case prior to entering formal mediation.
20A.	Consideration should be given to ASBFEO being a designated complainant.
21A.	Subsection 82(3) of the CCA could be amended to provide that applications for no adverse costs orders can be made in relation to contraventions of Part IVB and the ACL.

Recommendations	Implementation suggestions
22. The scope of penalties under the Code and associated investigation powers and infringement notice regime in Part IVB of the CCA should be increased.	22A. All substantive obligations placed on parties under the Code and in Division 5 of Part IVB of the CCA should be penalty provisions. 22B. Infringement notices should impose a penalty equivalent to the upper limit of infringement notices issued under the ACL (60 penalty units for a body corporate).
23. The Australian Government should investigate the feasibility of introducing a licensing regime to better regulate most aspects of the franchisee-franchisor relationship.	23A. Representatives of franchisees, franchisors and relevant government agencies including the ACCC should play a key role in examining this issue.

Appendix A: Drafting considerations

A number of stakeholders suggested changes to the drafting of the Code to ensure that the expression of the policy intent could be made clearer, to reduce unnecessary complexity, or to eliminate current unclear expression.

If the Code is remade, consideration should also be given to the modernisation of the Code to align with current drafting standards. This includes replacing outdated language, complex sentence structures, legalese and jargon with modern, idiomatic language.²⁶¹

To assist with the drafting process for re-making the Code, the issues outlined in the below list should be considered, drawing on the pertinent experience of practitioners and the regulator in working with the Code's provisions. This Appendix is not intended to be a comprehensive statement of all matters that should be considered when the Code is remade; it is expected that, consistent with the usual practice of government to consult on exposure drafts of legislation, there will be further opportunity for stakeholders to comment on a proposed new Code.

261 OPC, OPC's drafting services: a guide for clients, Seventh edition, Australian Government, Australian Government, July 2022, p 33.

Code Reference	Concern	Suggestion
Definitions Clause 4	Stakeholders identified terms in the Code without a clear definition. Undefined terms can cause inconsistency across the sector due to differing interpretations and legal advice. There was also a concern that the term 'electronic signature' is not used anywhere in the Code, even though it is defined in the Code. Given section 10 of the <i>Electronic Transactions Act 1999</i> (Cth) effectively allows for signing the disclosure document electronically, this definition may be redundant. There is a mention of electronic documents in clause 9(2C) stating that a person can request a disclosure document in either an electronic or physical form.	In remaking the Code all definitions should be analysed to ensure their relevance and accuracy. In particular, definitions for the following concepts/terms have been raised in submissions to the review: • Renew the franchise • Renew the franchise agreement • Enter into a new agreement • Renewal • Extend • Contractual right to renew the franchise • Extension of the term of the franchise agreement • Dispute • Overholding • Significant (in relation to capital expenditure) • Substantially identical (in relation to disclosure of leasing information). The electronic signature definition should be removed. A note in item 1.1(c) of Annexure 1 could be included referencing the <i>Electronic Transactions Act 1999</i> (Cth). Clause 9(2C) could be amended to refer to signing the form electronically.
Multiple clauses	Several elements of the Code contain potential inconsistent provisions.	In remaking the Code drafters should consider consistency across clauses, particularly in relation to the following provisions: • Item 18 of the disclosure document, relating to the term of agreement and arrangements to apply at the end of the agreement, contains inconsistencies. The wording of paragraphs 18.1(a), (b) and (c) could be aligned for more consistency. The warning statements in items 18.3 and 18.5 should refer to renewing the agreement (currently the warning refers to extending the term), and in 18.5 it should refer to both). • Item 4.2(b) and clause 17(3)(c), relating to disclosure of judgments against a franchisor under independent contractor laws, contain inconsistent disclosure requirements; the disclosure document does not require them to be disclosed but 17(3)(c) does. Annexure 1, 4.2(b) should be modified to refer to 4.1 generally, not only 4.1(a). • Item 21.4(b) and clause 8 – in circumstances where disclosure is delayed beyond the first 4 months of the financial year due to the operation of clause 8(7), item 21.4 should allow for any auditors' statement to be prepared in tandem with the date of disclosure rather than having to be strictly within the first 4 months after the end of the financial year.

Code Reference	Concern	Suggestion
Meaning of ‘disclosure document’ Various clauses; most relevantly clause 8	The correct interpretation of ‘disclosure document’ has implications for numerous clauses in the Code. Clause 8(1) requires a franchisor to ‘create a document (a disclosure document) relating to a franchise that complies with subclauses (3), (4) and (5).’ It is not clear whether, by virtue of the definition of ‘disclosure document’ in clause 8(1), subsequent references to ‘disclosure document’ throughout the Code should be read as: • a reference to a disclosure document that is entirely compliant with the requirements of clause 8 (that is, compliant with subclauses (3), (4) and (5) of clause 8, as contemplated by clause 8(1)) • a reference to any document that is created by a franchisor under clause 8 and intended to be a ‘disclosure document’, regardless of whether the document entirely complies with the requirements in subclauses (3), (4) and (5) of clause 8.	The Code should be amended to provide further clarity about what is and what is not a ‘disclosure document’ for all relevant clauses in the Code. The policy intent is that a document which purports to be a disclosure document should also be considered a disclosure document for other purposes (such as triggering the obligation to provide information for inclusion on the FDR per clause 53C of the Code).
Requirement to ‘update’ a disclosure document Subclause 8(6)	Subclause 8(6) requires franchisors to ‘update’ its disclosure document within 4 months after the end of each financial year. The Code does not specify what updates should be made to a disclosure document under this subclause.	The code should be amended to clarify, what updating a ‘disclosure document’ under subclause 8(6) entails. The policy intent of the Code is that the disclosure document should be updated to reflect the position of the franchise (and/or franchisor) as at the end of the financial year (see, for example, subclause 8(8)). This should be made more explicit in clause 8. It should also be clarified that the updated disclosure document must comply with the format of Annexure 1 as at the date of the update (that is, incorporating any amendments made to the Code since the disclosure document was created or last updated).
Marketing and cooperative funds Clause 15	Clause 15 applies ‘if a franchise agreement requires the franchisee to pay money to a marketing fund or other cooperative fund controlled or administered by or for the franchisor or a master franchisor.’ Separate to marketing and advertising, franchisors may require franchisees to contribute to various cooperative funds. For example, some franchisors impose a ‘technology fee,’ or require franchisees to contribute to a technology fund that is drawn upon to pay for certain upgrades to systems. There is uncertainty as to whether and how the obligations set out in clauses 15(2) and 15(4) of the Code apply in relation to cooperative funds that do not relate to marketing or advertising.	The Code be amended to include a clear definition of ‘cooperative fund’ and clarify the operation of clause 15 of the Code.

Code Reference	Concern	Suggestion
Obligation on franchisor to retain documents Clause 19	Clause 19 of the Code require franchisors to keep copies of written documents that a franchisee or prospective franchisee is required or permitted to give to the franchisor under the Code. However, clause 19 does not require franchisors to keep copies of written documents that the franchisor is required or permitted to give to a franchisee or prospective franchisee.	The Code be amended to require the franchisor to retain copies of documents that the franchisor is required or permitted to give to a franchisee or prospective franchisee. This would improve the ACCC's ability to check compliance with Code disclosure requirements.
Prohibition on certain clauses in franchise agreements Clauses 19A and 22	Several clauses of the Code prohibit franchisors from entering into franchise agreements which contain certain clauses, but the Code does not similarly prohibit franchisors from engaging in the conduct that is the subject of the prohibited clause.	The Code be amended to expressly prohibit franchisors from engaging in conduct that is the subject of a prohibited clause. A breach of such a provision should appropriately carry a pecuniary penalty.
Franchisors' legal costs Clause 19A	The Code currently prohibits franchisors from entering into agreements with clauses that have the effect of requiring or allowing the franchisor (or their associate) to require a franchisee to pay all or part of the franchisor's legal costs relating to the preparation, negotiation or execution of the agreement, or documents relating to the agreement. However, the Code provides an exception to this prohibition whereby franchisors may require a franchisee to make a payment, before the franchisee starts the franchised business, of a fixed sum with no evidence of the genuine legal costs incurred by the franchisor.	The Code be amended to ensure that the fixed sum does not exceed the franchisor's <i>reasonable or genuine</i> costs associated with preparing, negotiating or executing the agreement.
Costs to settle a dispute Clause 22	The Code prohibits franchisors from entering 'into a franchise agreement that includes a provision that requires the franchisee to pay to the franchisor costs incurred by the franchisor in relation to settling a dispute under the agreement'. The wording of clause 22 does not expressly prohibit the franchise agreement from requiring the franchisee to pay costs incurred by the franchisor to a third party. Further, the word 'dispute' is not defined in the Code. It is not clear whether 'dispute', in the context of clause 22, is intended to encompass both formal and informal disputes.	The Code be amended to include a definition of 'dispute' and to make it clear that, consistent with the policy intent, the Code prohibits requiring franchisees to pay the franchisor's costs to any party, in both formal and informal disputes.
Termination for insolvency Paragraph 29(1)(b)	Paragraph 29(1)(b) relates to a franchisor terminating a franchise agreement because a franchisee has become bankrupt or insolvent under administration. This is inconsistent with changes to the law introduced in 2018 which prevent the use of 'ipso facto' clauses relating to termination for insolvency – see section 451E of the <i>Corporations Act 2001</i> (Cth).	Consideration should be given to modifying subclause 29(1) to remove paragraph 29(1)(b); this paragraph would appear to be redundant in light of changes to the <i>Corporations Act 2001</i> (Cth) since the provision was originally introduced.

Code Reference	Concern	Suggestion
Former franchisees' contact details Clause 32 and Annexure 1 Item 6.5	The Code requires franchisors to provide contact details of former franchisees in the disclosure document. The policy intent is to assist a prospective franchisee in conducting their due diligence before entering into an agreement. The Code prohibits a franchisor from engaging in conduct with the intention of influencing a former franchisee to make, or not make, a request to not have their contact details disclosed to prospective franchisees. The ACCC has observed that it is common for franchisors to only disclose the former franchised business's phone number, email address or physical address.	The Code should be amended to enable disclosure of contact details so that prospective franchisees can contact former franchisees. It would be helpful to specify that this should include the most recent email address and mobile phone number where known by the franchisor. The interaction between the disclosure of this information and Australia's privacy principles should be considered. If necessary, clarification should be provided in the Code.
Inappropriate use of contractual terms Clause 46B	Concerns were raised that OEMs are including terms in standard form agreements stating that franchisee agrees that the contract provides them with a reasonable opportunity to make a return on investment.	Whether such terms are legally effective or not, they undermine the policy intent of the provision and may lead to confusion for franchisees. Clause 46B should be amended to prevent the inclusion of such terms in contracts. This is consistent with the policy intent of the Code that franchisee agreements should not be used to release the franchisor from legal liability (see, for example, clause 20).
Disclosure of Fair Work Act actions Annexure 1 Item 4.1(b), 4.2(b) and 17.3(c)	The <i>Fair Work Act 2009</i> (Cth) empowers Fair Work to prosecute franchisors, yet proceedings and judgments under this regime are not currently expressly included in disclosure requirements.	Amend and expand item 4 and clause 17(3)(c) to require disclosure of any proceedings or judgments against a responsible franchisor entity for contravention of section 558B of the <i>Fair Work Act 2009</i> (Cth).
Significant capital expenditure Annexure 1 Item 14.10, Subclause 30A(2)	Item 14 requires disclosure of 'other payments' that are payable from the franchisee to the franchisor, including significant capital expenditure. Stakeholders complained that insufficient information is often provided about these costs. Subclause 30A(2) specifies information that must be included in the disclosure document regarding significant capital expenditure; these requirements should appear in 14.10.	Amend item 14.10 so that the information required to be included in the disclosure document by virtue of subclause 30A(2) is explicitly referenced in item 14.10. Further clarity could also be provided by specifying that if the amount of the capital expenditure cannot be easily calculated, then the upper and lower limits of the amounts must be disclosed (consistent with other disclosure requirements relating to costs).

Appendix B: Franchisee survey

Objectives of the survey and methodology

Background

The purpose of this online survey was to obtain a greater broad-based understanding of the franchisee perspective of matters investigated in this review. The survey was designed to establish a baseline measure of key issues using quantitative measures which were largely absent in individual submissions to the review.

There is value in this survey being conducted again in future Code reviews, as it will allow government to track longitudinal changes.

Sample

The sampling frame for the research was current and former franchisees who are regulated by the Code. As of September 2023, there were an estimated 72,875 franchisees according to the FDR, managed by the Department of the Treasury.

Franchise industry bodies and professional advisors were asked to promote the survey among their franchisee networks. Promotion of the survey was also conducted by social media channels, via the Department of the Treasury's review website, alongside promotion by Commonwealth and state regulators.

A total of 381 responses were received.

Questionnaire development

The draft questionnaire was developed by the independent reviewer with support from the review secretariat.

Fieldwork

The online survey was conducted from 4 to 20 October 2023 and was hosted by the Department of the Treasury.

Statistical precision

The survey is subject to non-sampling measurement errors, with the main non-sampling error risk being the potential for non-response bias to affect results.

Presentation of results

Reported percentages are based on the total number of valid responses made to the question being reported on. This occasionally differs from the total number of completed survey questionnaires because of omissions in the completed questionnaires. The results reflect the responses of people who had a view and for whom the questions were applicable. 'Don't know/ unsure' responses have only been presented where this aids in the interpretation of the results.

In cases where the counterfactual and its percentage have not been explicitly stated, the counterfactual's percentage is the remaining, unstated percentage.

Quality and Compliance Statement

This project was conducted in accordance with the Australian Privacy Principles contained in the *Privacy Act 1988* (Cth).

Overview of survey results

Survey response and business type distribution

Most respondents were current franchisees with more than 3 years of franchising experience (302 out of 381). The predominant business types among respondents were 'motor vehicle dealerships' (173), 'retail sales' (126), 'trades and services' (30) and 'other' (52) responses. The 'other' category included a broad cross-section related to retail services and consulting work.

Franchisor-franchisee working relationship

The average rating for the working relationship with franchisors is moderately positive (around 5.7), suggesting a mixed level of satisfaction among franchisees. There is a significant spread in the ratings, indicating diverse experiences and perceptions among franchisees regarding their relationship with franchisors. A notable proportion of respondents (around 26%) rated their relationship in the lower end (1 to 3), indicating areas of concern or dissatisfaction.

Franchise regulation and regulators

The average rating for the effectiveness of the ACCC in regulating the franchise sector is 3.9, indicating moderate to low satisfaction with regulatory oversight.

A significant number of respondents (40.4%) rate the regulatory effectiveness of the Code as low (1 to 3), suggesting a perceived need for improvement in this area.

Suggestions for changes to the Franchising Code

The suggestions for changes are varied, but common themes include a desire for more transparency, better communication, fair treatment, and updated regulations to protect franchisee interests.

Comparison of franchisees by business type

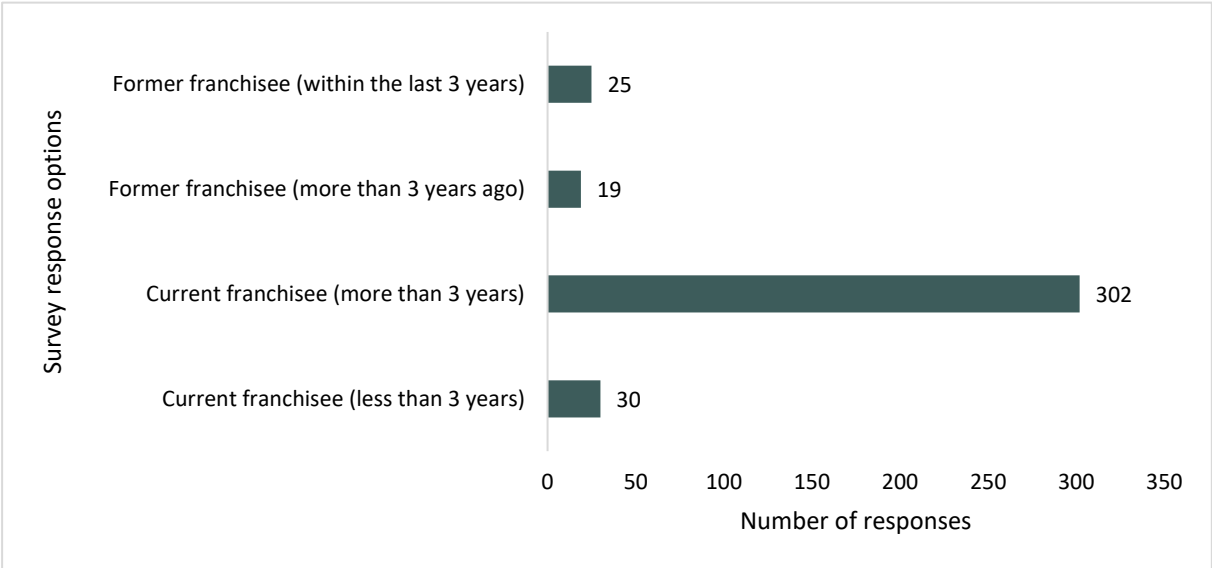
Only a limited degree of comparison between franchisees in different industries is possible, given the very broad industry classifications used and the limited number of respondents in some data cohorts. Table 1 provides some preliminary analysis.

Table 7: Satisfaction with franchisors and assessment of the Franchising Code

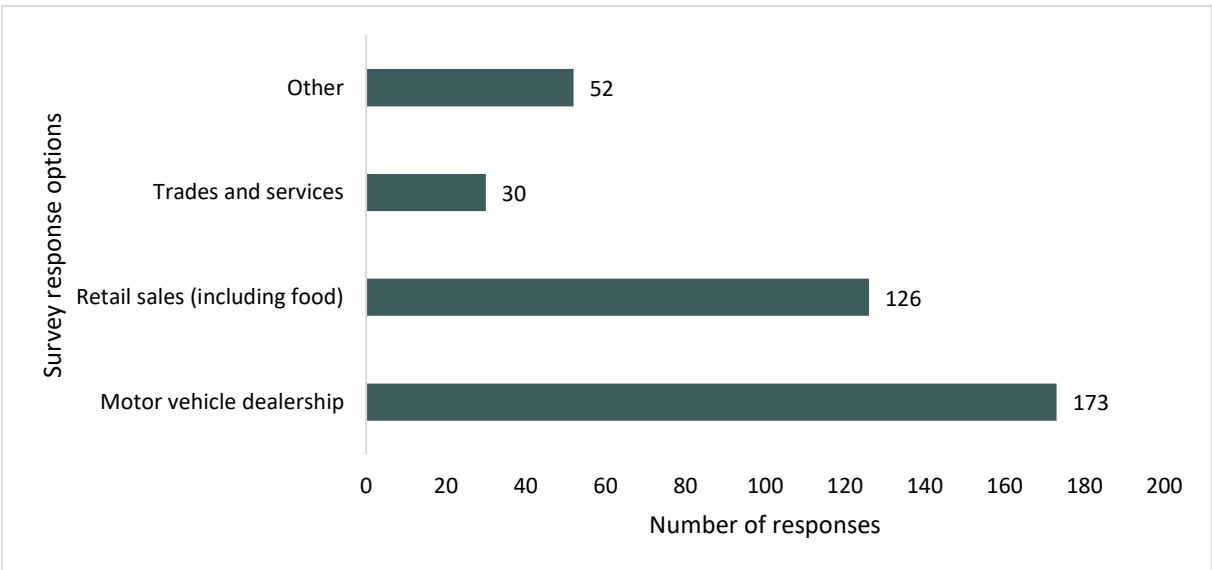
Respondent type	Average franchisee satisfaction with franchisor	Average rating for effectiveness of the Code
Motor vehicle dealerships	6.3	3.9
Retail sales	5.2	4.2
Trades and services	4.5	3.5
Other (for example, retail and consulting services)	5.4	4.2

Survey questions and responses

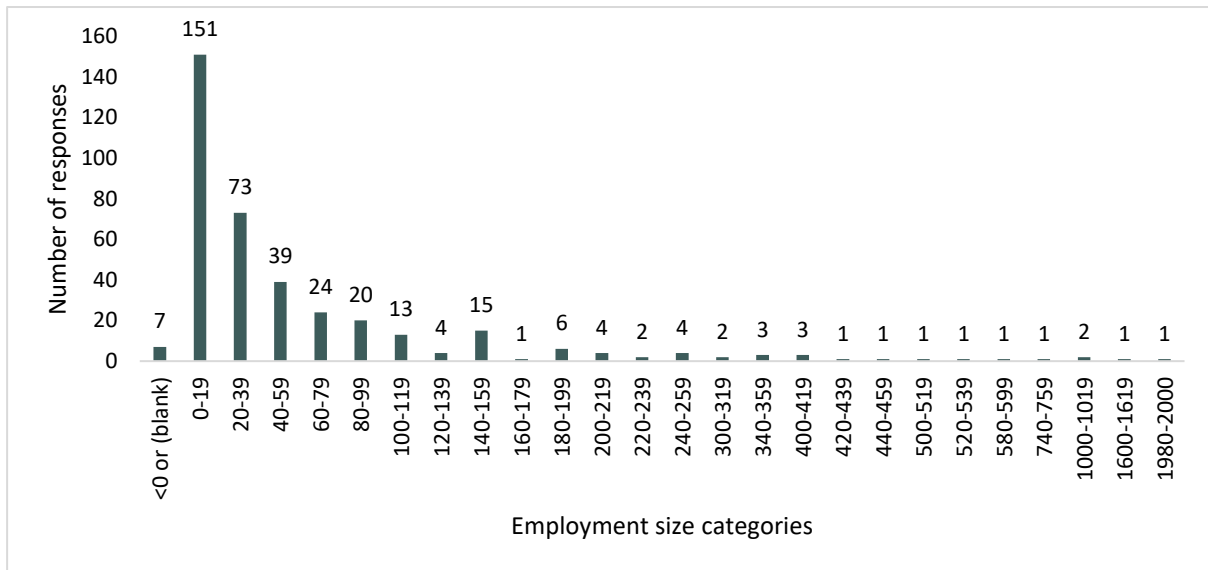
Question 1: Which of the following best describes you?



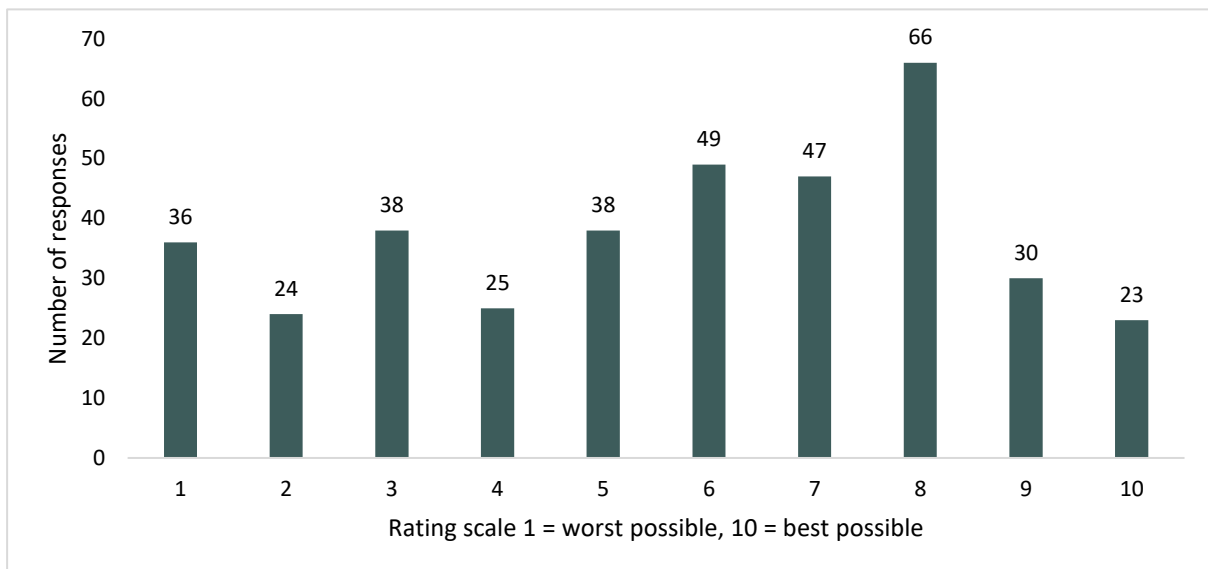
Question 2: Which of the following best describes the type of business you operate?



Question 3: How many people, including yourself, work in your business? (median = 28.0, mean 58.0²⁶²)

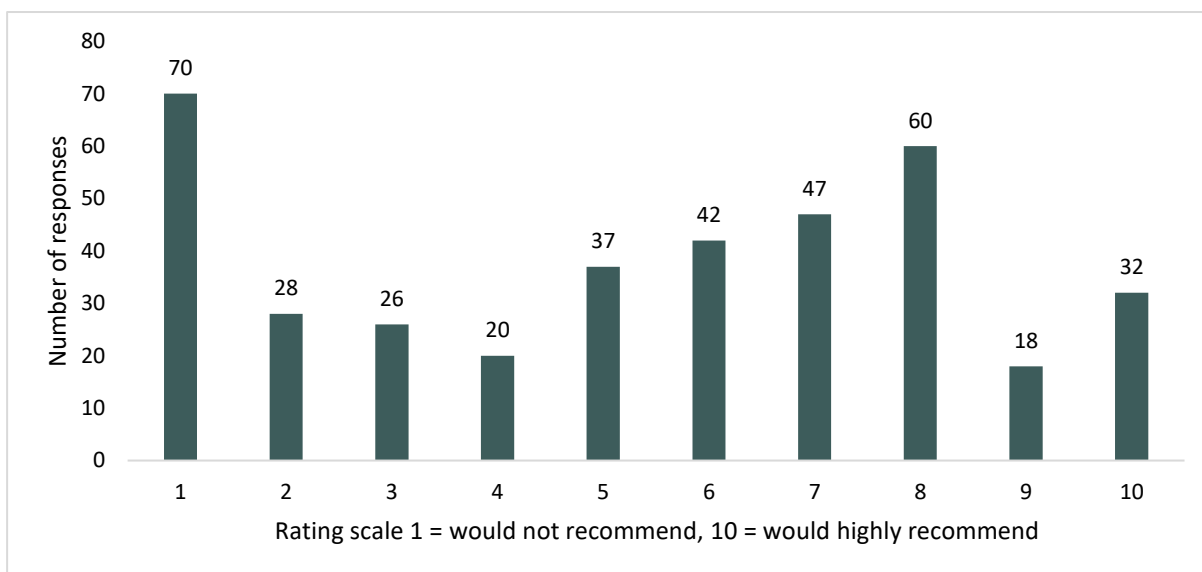


Question 4: How would you describe your working relationship with your franchisor? (median = 6.0, mean = 5.7)

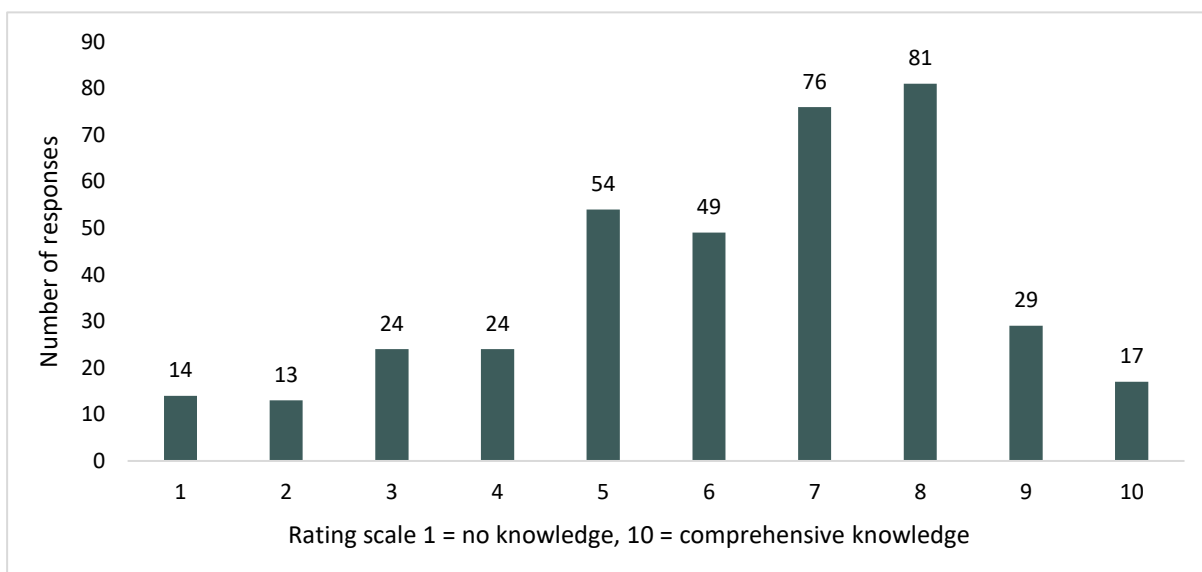


²⁶² The raw mean for this question was significantly skewed by outlier responses. To produce a more accurate 'mean' for this question 12 outlier responses have been excluded. The most common category is the one with the midpoint of 9.5, which corresponds to the range of 0–19 employees, which appeared 151 times.

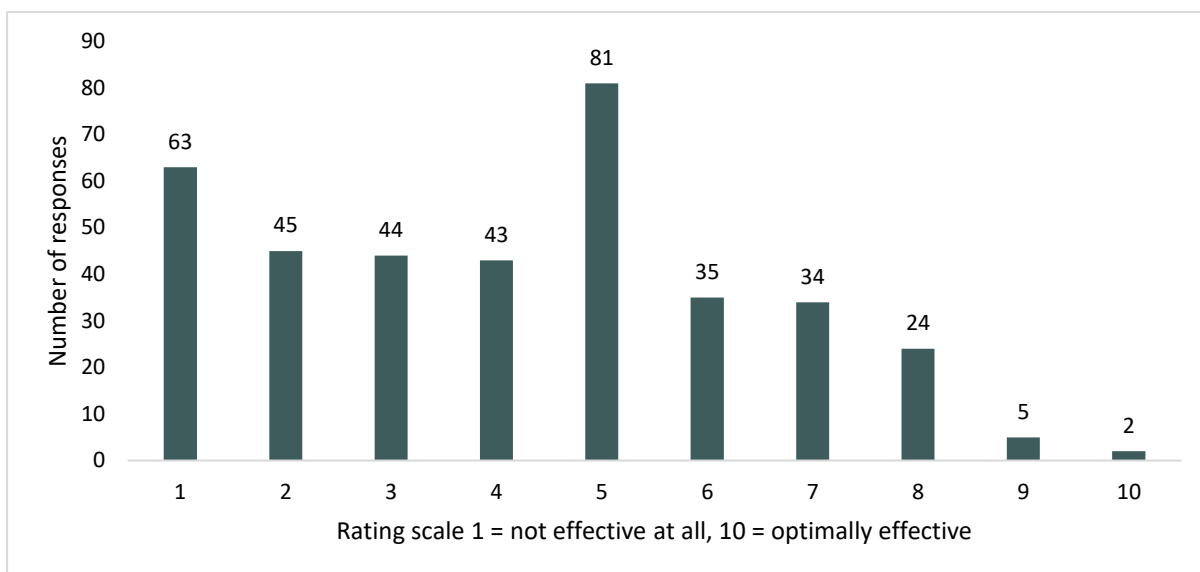
Question 5: How likely would you be to recommend franchising to others? (median = 6.0, mean = 5.3)



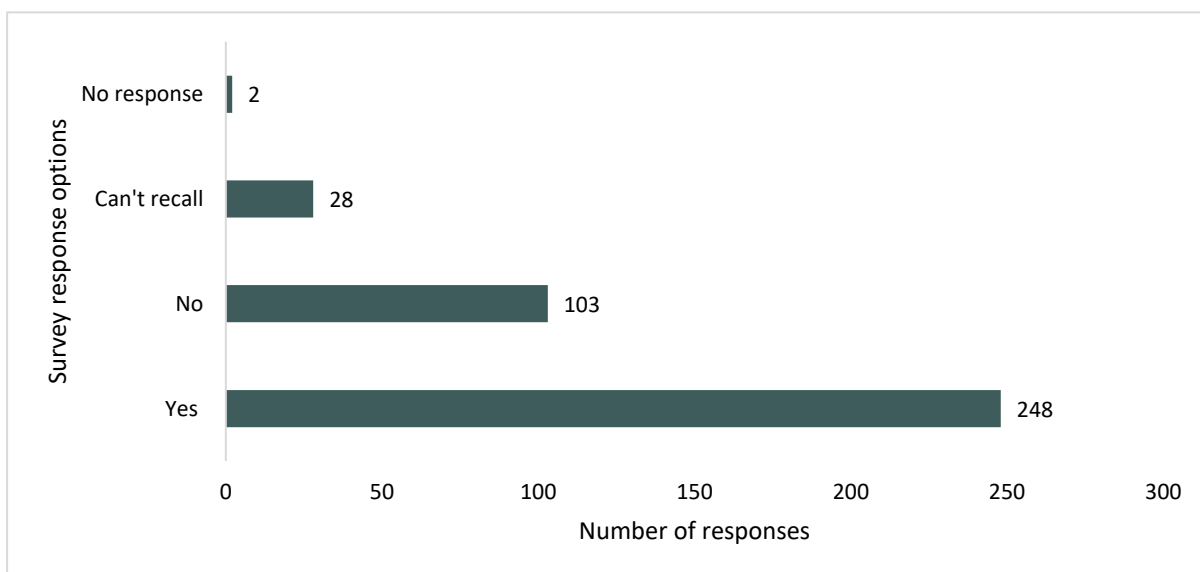
Question 6: How would you rate your knowledge of the Franchising Code? (median = 7.0, mean = 6.3)



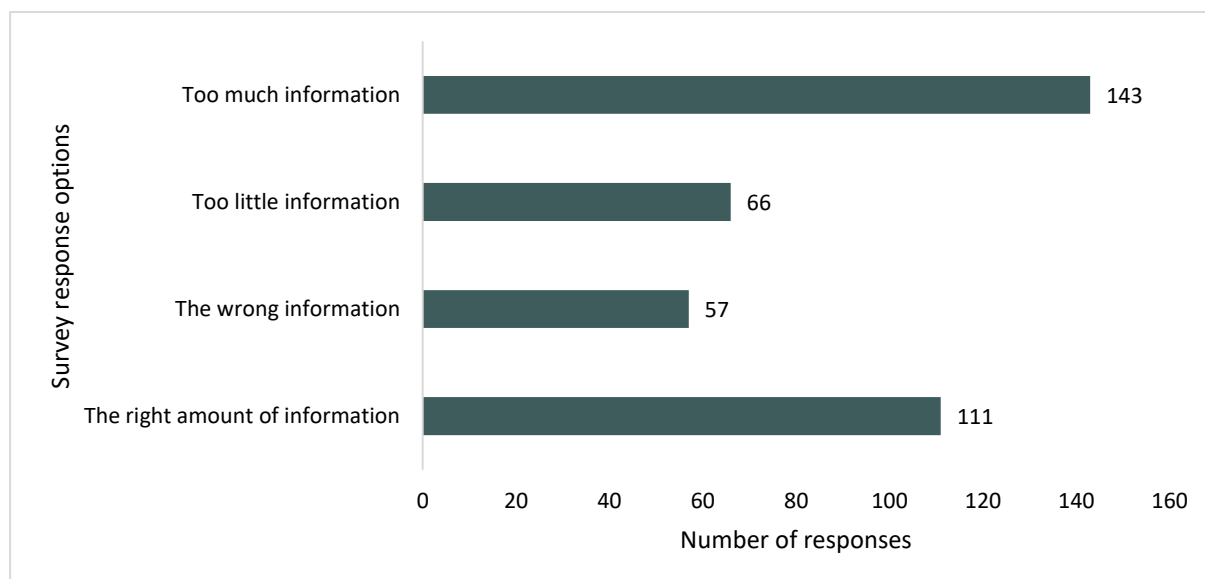
Question 7: How effective do you think the Franchising Code is?
(median = 4.0, mean = 4.2)



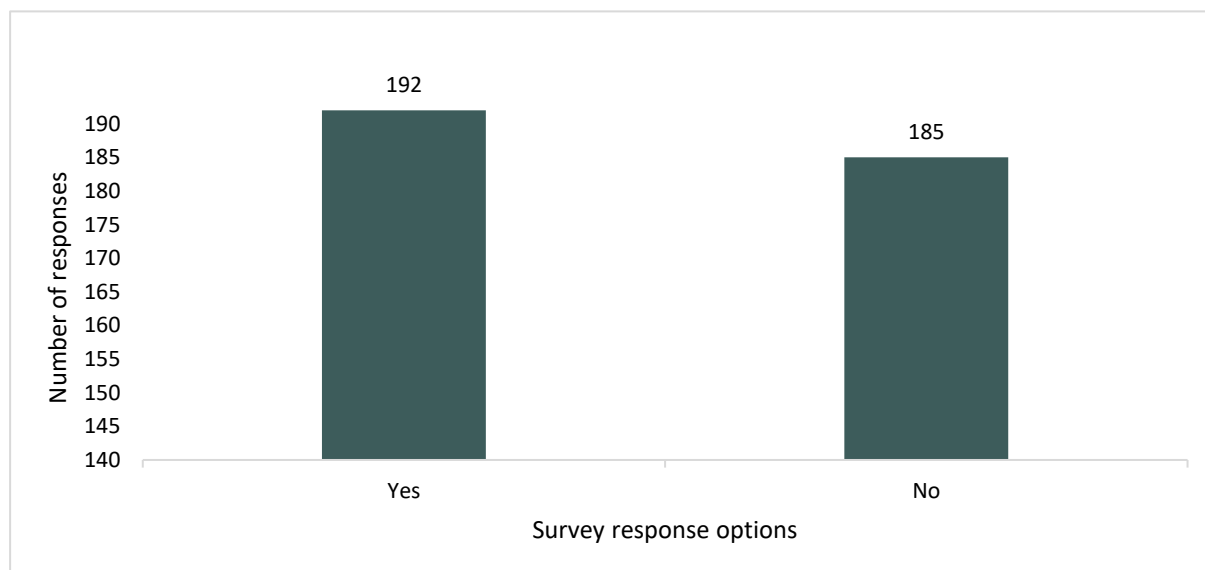
Question 8: Did you receive advice from an independent lawyer, accountant or business advisor before entering into franchising?



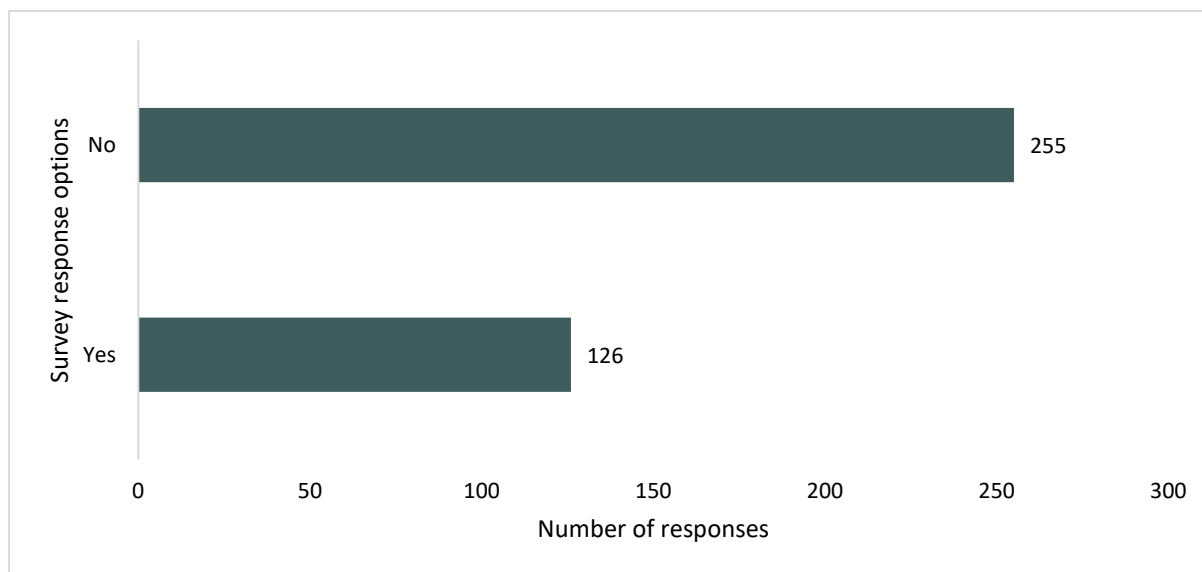
Question 9: Which of the following answers best describes the disclosure document and other material you received before entering into your franchise agreement?



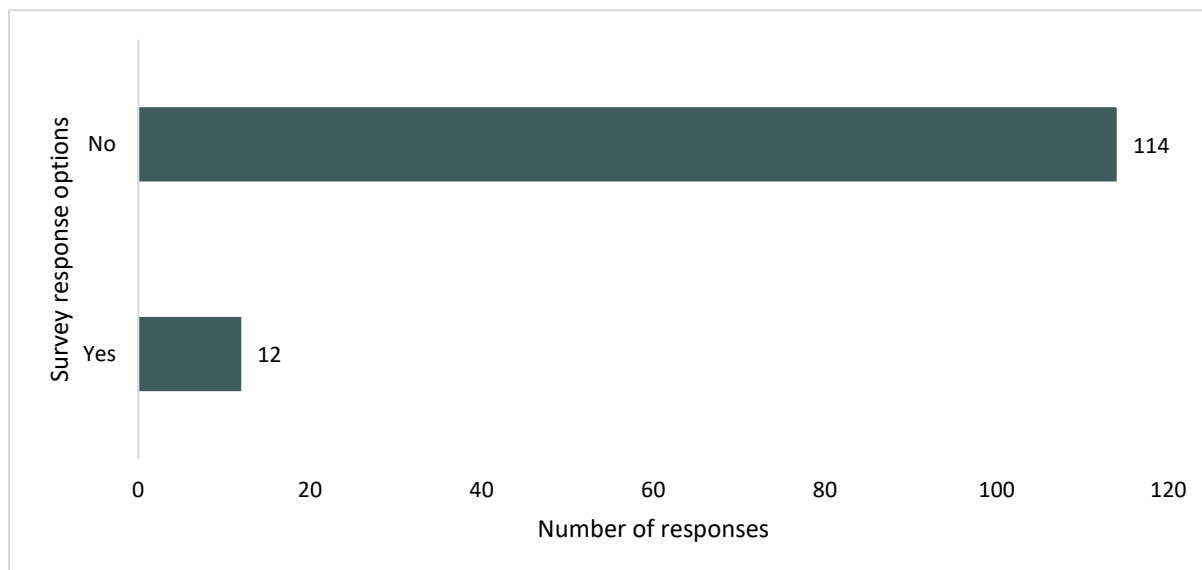
Question 10: Are you aware of the mandatory dispute resolution support services provided by the Australian Small Business and Family Enterprise Ombudsman?



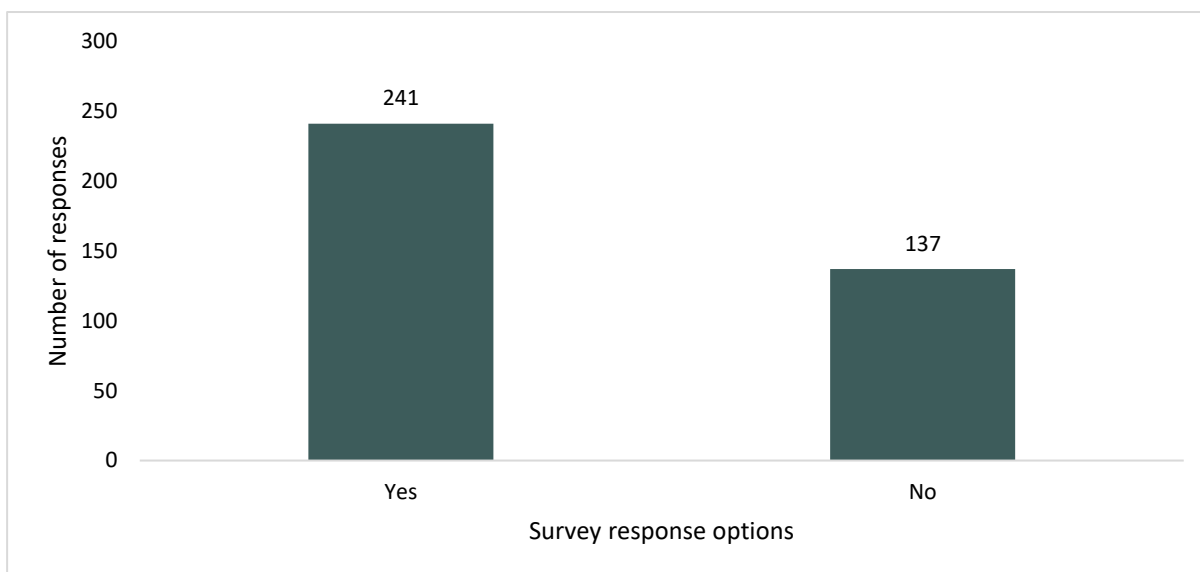
Question 11: Have you had a serious dispute with your franchisor in the last 12 months?



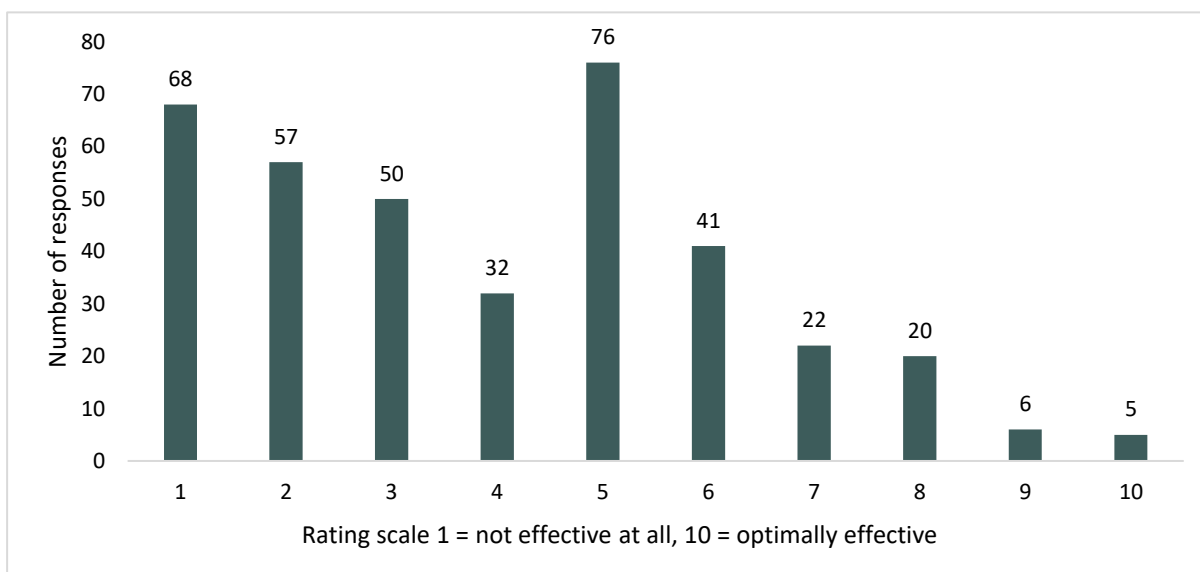
Question 12: Were you able to resolve the dispute effectively?



Question 13: Are you aware of the role of the Australian Competition and Consumer Commission in regulating the sector?



Question 14: How effective do you think the Australian Competition and Consumer Commission is in regulating the franchise sector? (median = 4.0, mean = 4.0)



Question 15: If you could change one thing about the rules for franchising, what would it be?

This was a free text field, limited to 200 characters. 288 respondents provided a response to the question.

Table 8: Franchisee survey free text response analysis

Topic	Most common words	Representative responses
Franchise relationship	Franchisor, franchise, business, power, agreement, dealer, franchisee	• There should be a Franchise Code specific to the car industry. • Franchisors should be accountable to franchisees for their sustainability and profitability. • Use profit sharing models, which should align incentives.
Financial concerns & disclosure	Rebates, disclosure, profitable, mandatory, network, time, cost, franchisee	• Minimise difference between information given in the agreement and actual operation of the business. • The Code should be amended to disallow or terminate an agreement due to business model change.
Fairness & financial agreements	Franchisor, franchisee, agreement, financial, change, fair	• Franchisors should not be allowed to force significant capital expenses on franchisees. • There is a need to protect franchisees from unfair behaviour.
Supply chains & disclosure	Disclosure, transparency, cost, rule, business model	• Need an opt out option if the forced supply chain is not competitive. • Franchisors should run at least 1 or 2 'model' stores. • Increased auditing from the ACCC of franchisors to deter bad behaviour. • The Code needs to be more prescriptive.
Franchisee needs & information	Agreement, need, information, franchisees, and business	• Adopt standardised and easy to understand disclosure. • The ACCC should oversee dispute resolution, which should be compulsory and arbitrated.

Appendix C: Franchise Disclosure Register survey

Objectives of the survey and methodology

Background

This survey was focused on obtaining baseline data about the user experience when using the Franchise disclosure Register.

As with the franchise survey discussed in detail in Appendix B, it was designed to establish a baseline measure of key issues using quantitative measures which were largely absent in individual submissions to the review.

There is value in this survey being conducted again in future Code reviews, as it will allow government to track changes in the user experience over time.

Sample

The sample population were users of the FDR website. As of 15 November 2023, 1,772 franchisors profiles (reporting a total of 73,335 franchisees) were registered with the FDR, managed by the Department of the Treasury. Franchisors are required to be registered with the website.

The survey email was sent on 15 November 2023 to all registered franchisors and promoted on the FDR home page. Franchise industry bodies and professional advisors were also asked to promote the survey among their franchisee networks.

Promotion of the survey was also conducted by social media channels, via the Department of the Treasury's review website, alongside promotion by Commonwealth and state regulators.

A total of 163 responses were received.

Questionnaire development

The draft questionnaire was developed by the independent reviewer with support from the review secretariat.

Fieldwork

The online survey was conducted from 15 to 26 November 2023 and was hosted by the Department of the Treasury.

Statistical precision

The survey selection and population covered all franchisor users, who are required by law to register on the FDR. Non-sampling errors were identified, including under coverage for non-franchisor respondents and partial non-response bias.

Dissent bias may occur in the survey as use of the FDR is a mandated requirement and the survey occurred in a period aligned with an annual update of FDR profiles.

Presentation of results

Reported percentages are based on the total number of valid responses made to the question being reported on. This occasionally differs from the total number of completed survey questionnaires because of omissions in the completed questionnaires. The results reflect the responses of people who had a view and for whom the questions were applicable. For example, only non-franchisor users were asked what their main purpose was for visiting the FDR. 'Don't know/unsure/no answer' responses have only been presented where this aids in the interpretation of the results.

In cases where the counterfactual and its percentage have not been explicitly stated, the counterfactual's percentage is the remaining, unstated percentage.

Quality and Compliance Statement

This project was conducted in accordance with the Australian Privacy Principles contained in the *Privacy Act 1988* (Cth).

Key themes insights from survey responses

Whilst 163 responses is an acceptable number for basic statistical analysis, it represents only 9.0% of all potential responses. As such, readers should note that there is a potential for response bias, and the results may not fully represent all users of the FDR.

Nonetheless, some notable insights have been obtained from the results.

A key theme was the challenging user experience on the FDR website. Suggestions for improvement included enhancing the user interface, simplifying processes, and providing clearer instructions.

Many respondents, particularly those creating profiles for the first time, suggested additional support services like help guides, FAQs, or live support could be beneficial.

User feedback suggested that improving the ability to compare and benchmark franchisors was important. The main areas nominated for improvement were the quality and accuracy of franchise purchase ranges, compliance activities to ensure all franchisors are registered, and improved search options.

Overview of survey results

Survey respondents and effectiveness of the FDR

To evaluate the FDR's effectiveness, a 1–10 rating scale was used, with 1 being not effective at all and 10 being optimally effective. The overall effectiveness rating was 4.2/10. The effectiveness rating is further broken down by group in Table 9.

Table 9: Survey respondent categories and effectiveness of the FDR

Survey respondents	Count of responses	% of total responses	Avg effectiveness rating of the FDR
Current franchisor with 10 or more franchisees	101	62.0	4.2
Current franchisor with under 10 franchisees	25	15.3	5.0
Providing support services to franchisees (for example, lawyer, accountant, business advisor)	11	6.7	4.3
Providing support services to franchisors (for example, lawyer, accountant, business advisor)	18	11.0	3.5
Other (for example, researchers, franchisees, unknown)	8	5.0	4.2
Total	163	100	

FDR comparison and user experience

A significant number of franchisors, particularly those with fewer than 10 franchisees, found the FDR more challenging than other government registration requirements. Approximately 40.0–45.0% of franchisors stated that the FDR experience was similar to other government website processes.

Most franchisors spent over 30 minutes creating a new profile. Across the different cohorts, 45.0–48.0% were unable to complete their profile in one session, indicating issues with the process or the volume of required information.

Table 10: FDR comparison and user experience

Group	Comparison with other government websites	Time taken to create a profile	Ability to complete profile in one session
Current franchisor (>10)	44.6% about the same, 25.7% harder	57.4% >30 minutes	45.5% could not
Current franchisors (<10)	36.0% about the same, 40.0% harder	76.0% >30 minutes	48.0% could not
Support services to franchisors	41.2% about the same, 35.3% harder	41.2% >30 minutes	41.2% could not

Information provided on the FDR

Perceptions as to the appropriate amount of information supplied to franchisees on the FDR varied significantly amongst franchisors and their advisors. Larger franchisors and advisors had similar views – namely, that the information provided on the FDR was ‘the right amount of information’, at 44.6% and 43.8%, respectively. However, only 28.0% of smaller franchisors agreed the right amount of information was provided. Concerns among smaller franchisors included too much information (44.0%), the wrong information (20.0%), and too little information (8.0%).

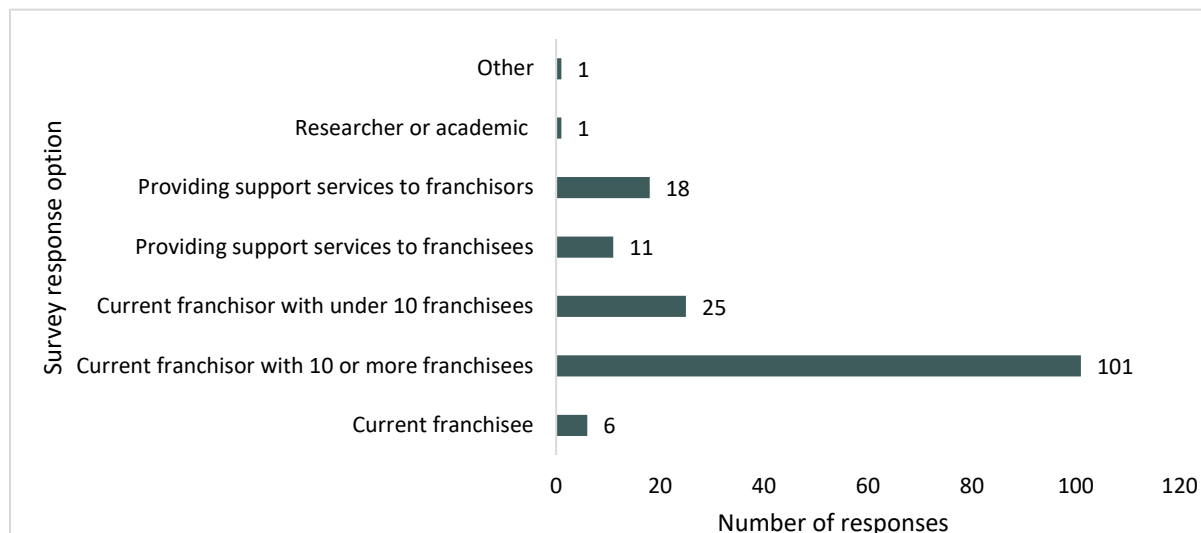
Overall, respondents expressed more concern about the quantity rather than the quality or adequacy of the information provided, suggesting issues with information volume.

Table 11: Franchisor summary of views on the amount of information on the FDR

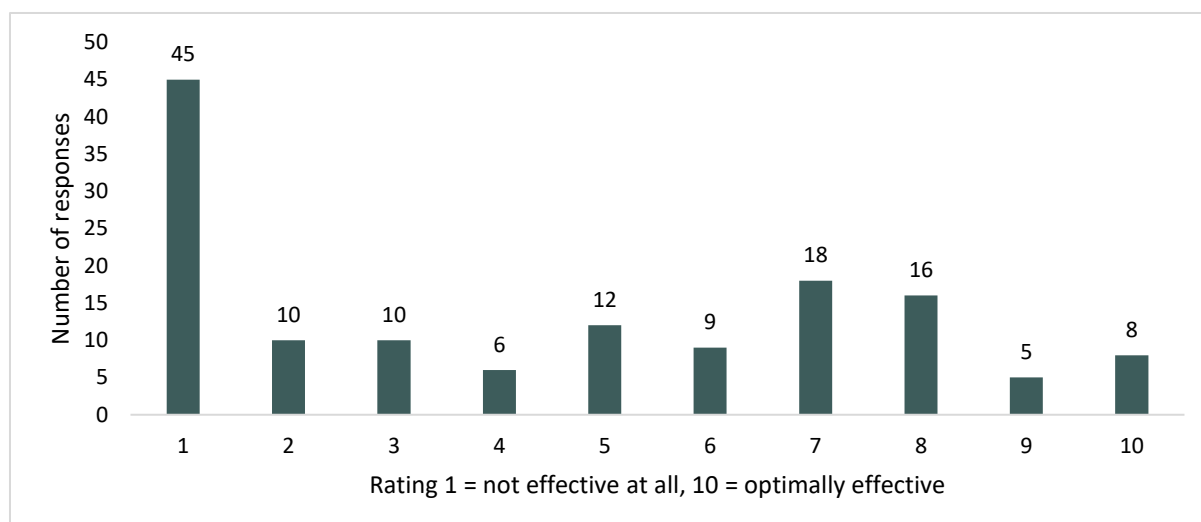
Group	The right amount of information (%)	Too much information (%)	The wrong information (%)	Too little information (%)
Current franchisor (>10)	44.6	37.6	15.8	2.0
Current franchisors (<10)	28.0	44.0	20.0	8.0
Support services to franchisors	43.8	31.3	18.8	6.3

Survey questions and responses

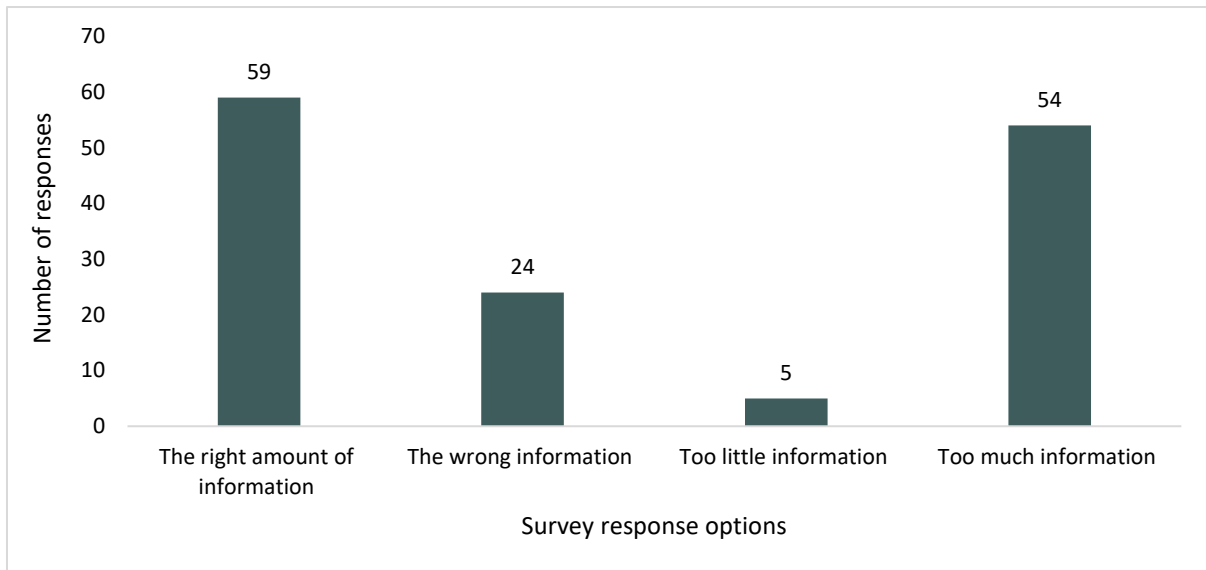
Question 1: Please identify yourself as one of the following:



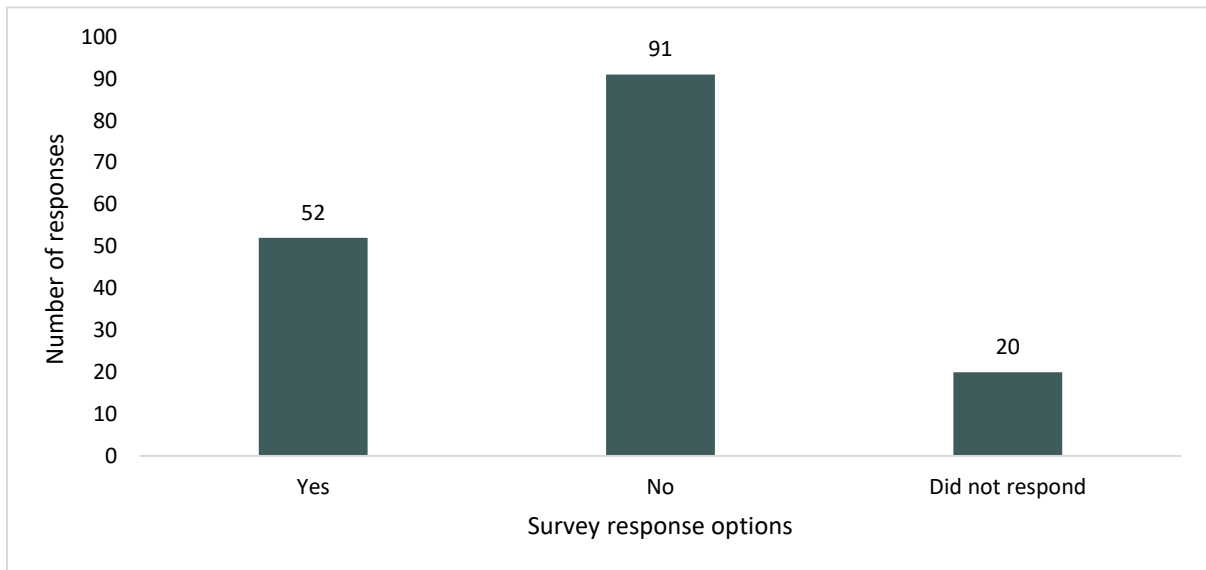
Question 2: Overall, how effective do you think the Register is in providing information to franchisees? (median = 3.0, mean = 4.2)



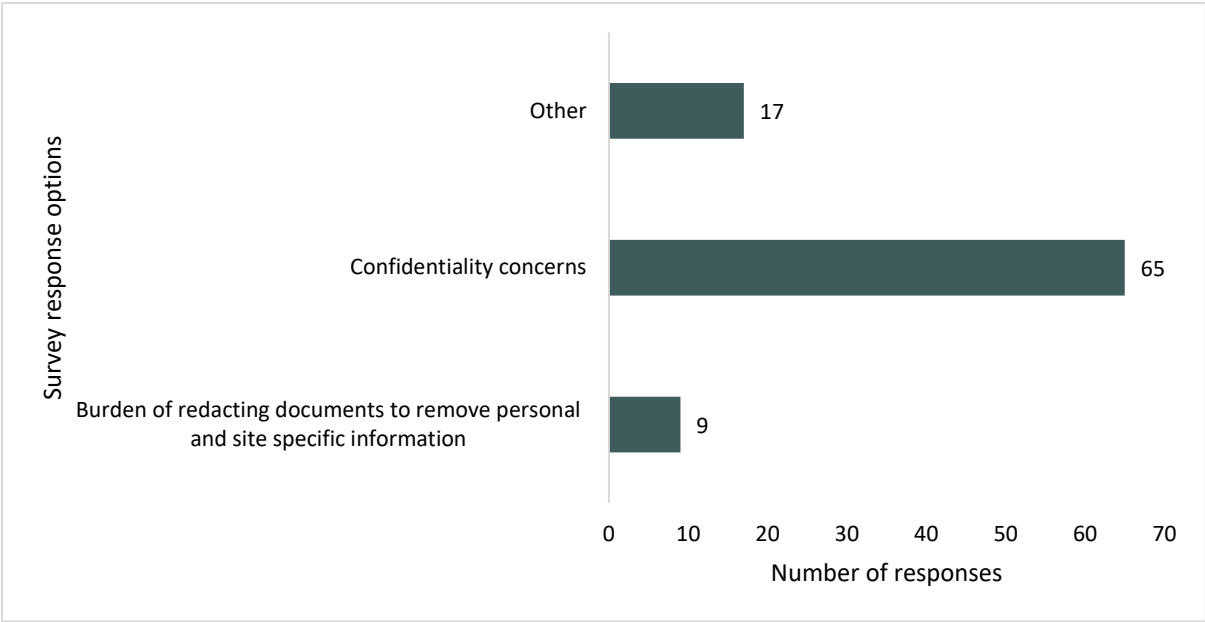
Question 3: Which of the following answers best describes the information you are required to provide to franchisees via the Register?



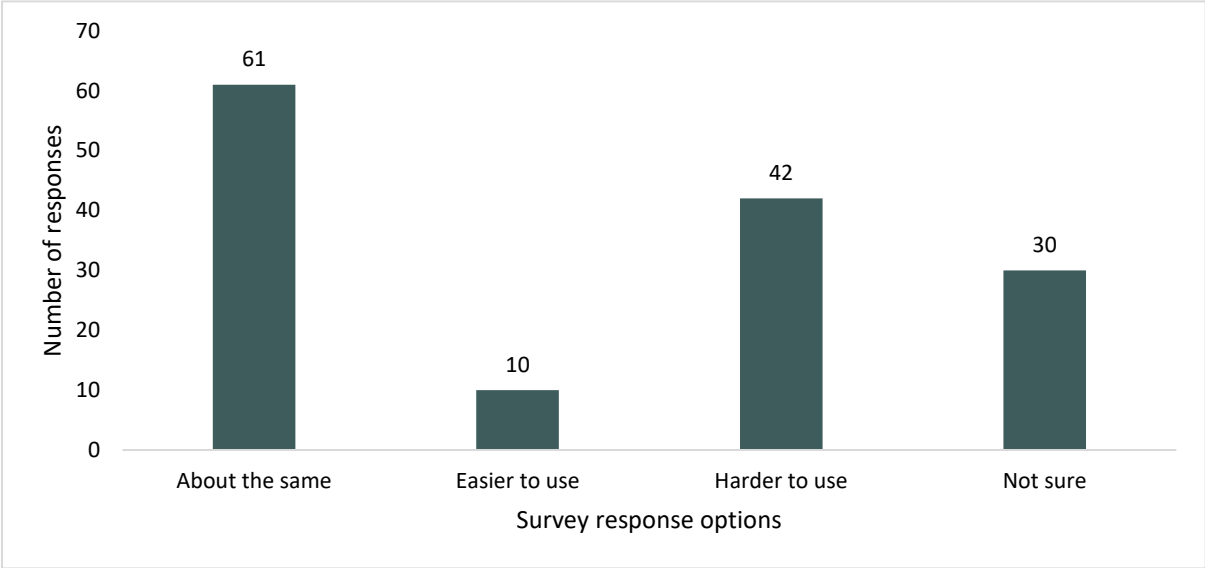
Question 4: Have you voluntarily uploaded a copy of any of the following to the Register: disclosure document, franchise agreement or key facts sheet?



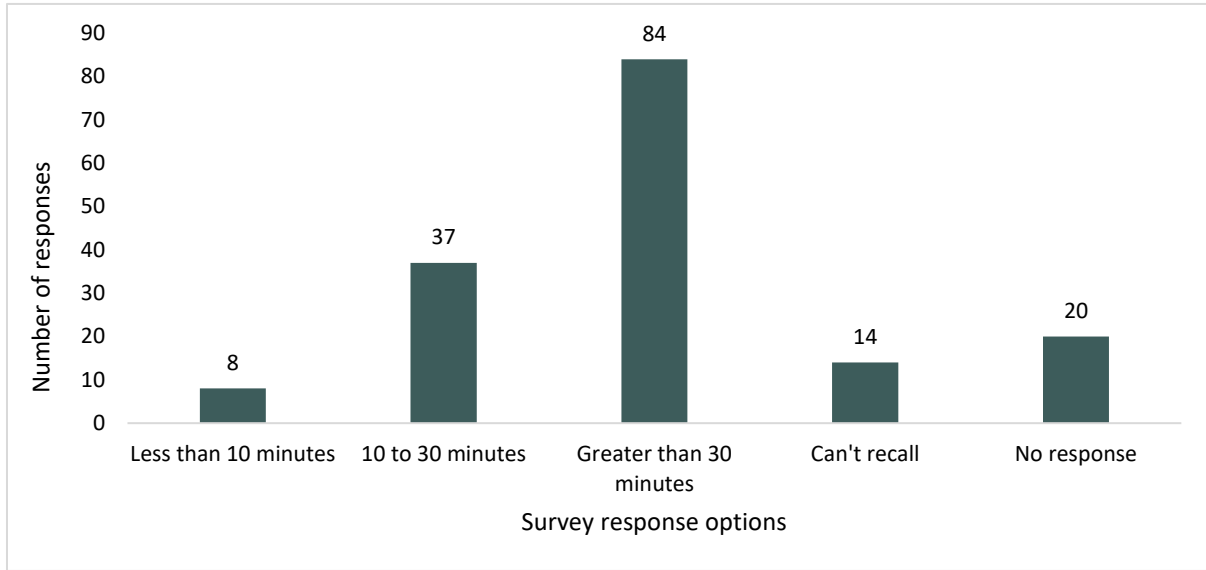
Question 5: If no, please identify the main reason you have chosen not to voluntarily upload these documents?



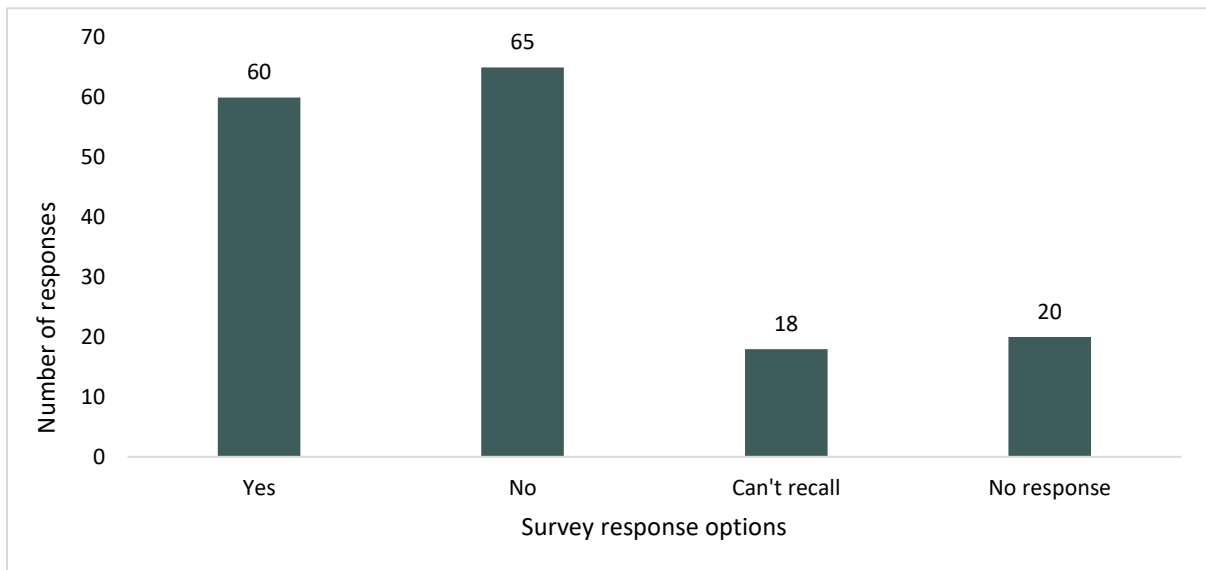
Question 6: How does the Register compare with other government registration processes you have experienced?



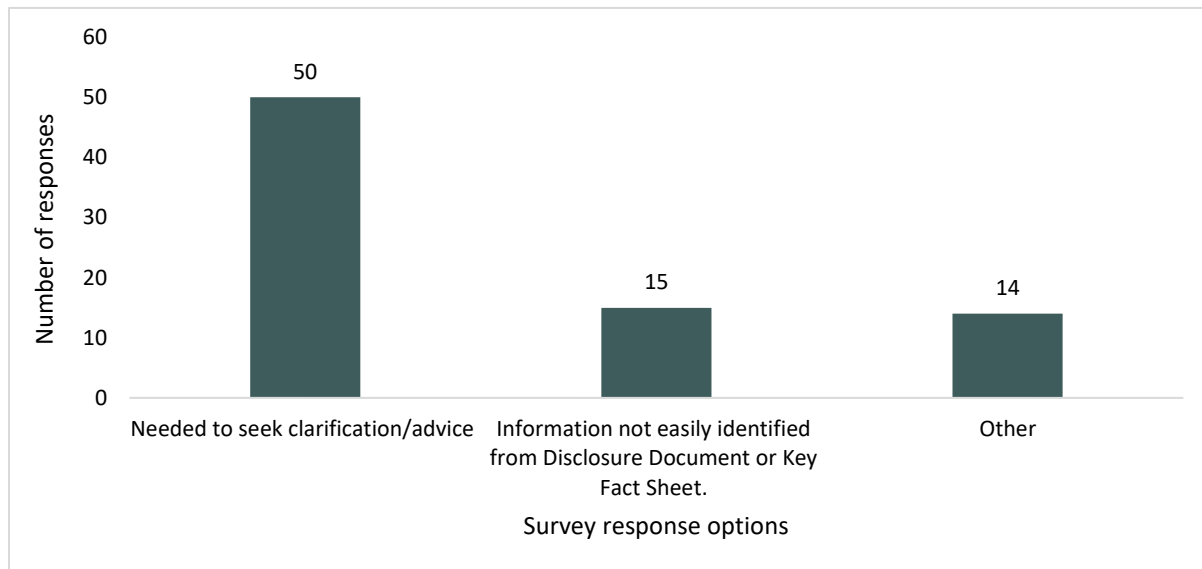
Question 7: How long did it take you to create a new franchise profile?



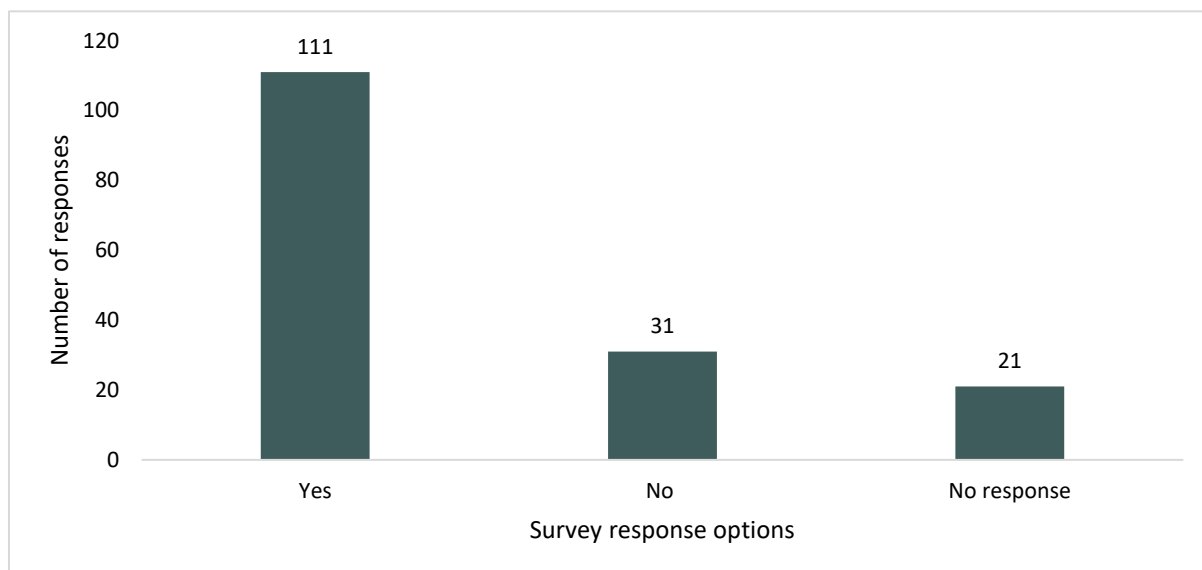
Question 8: Were you able to complete your profile in one session?



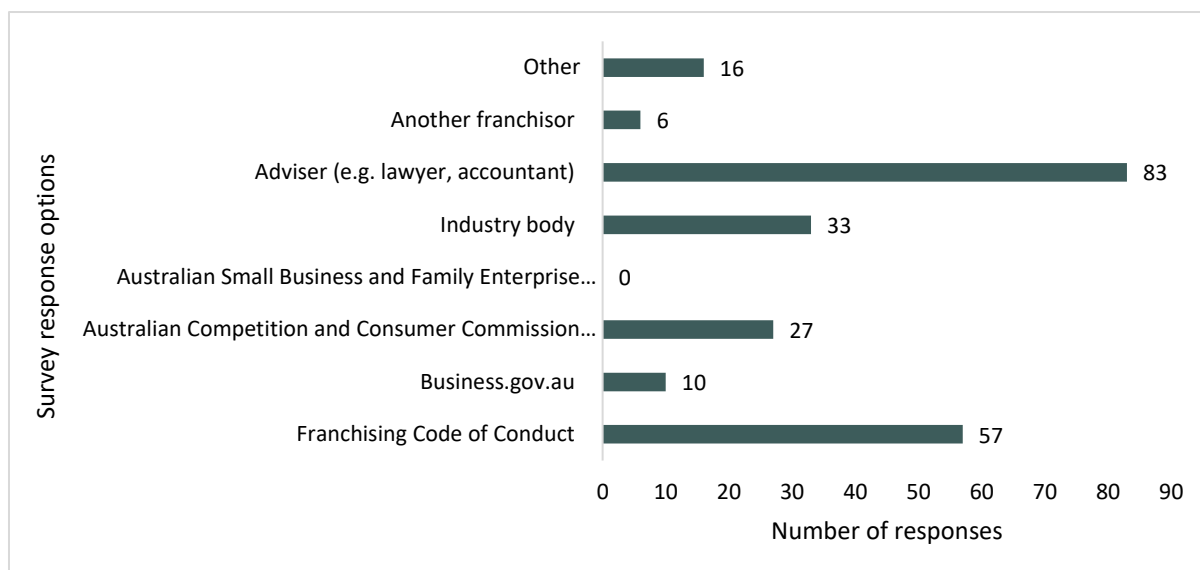
Question 9: If no, why? Choose as many as apply.



Question 10: Did you seek advice from a lawyer to support your organisation to meet the obligations in Part 5A of the Franchising Code requiring registration of franchisors?

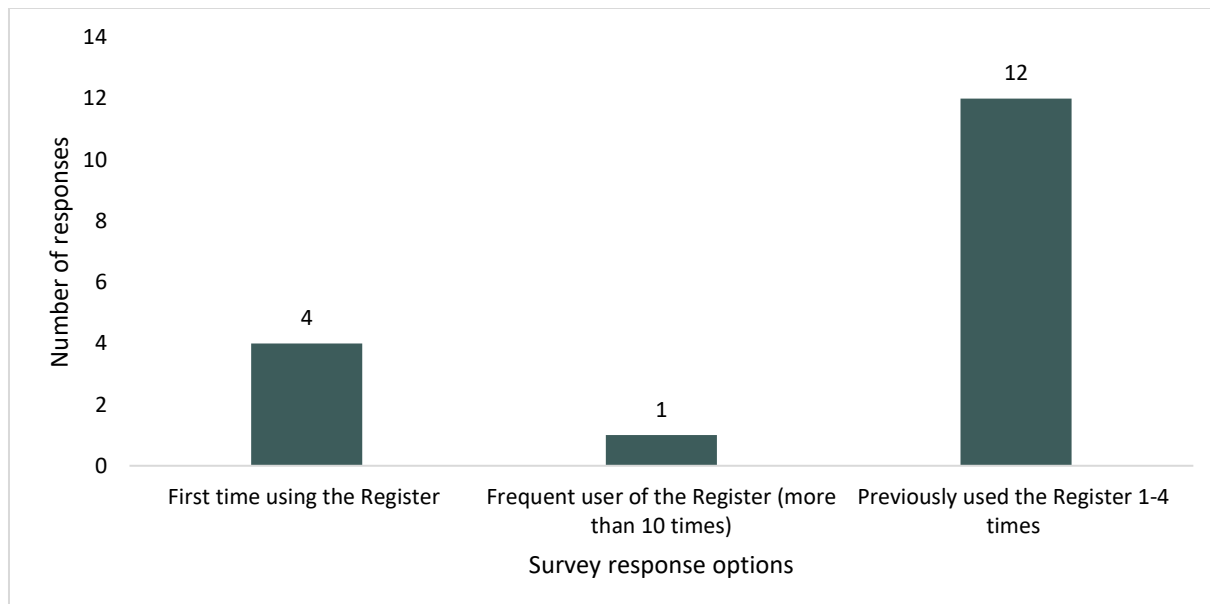


Question 11: How did you learn about the Franchise Disclosure Register? Choose as many as apply.



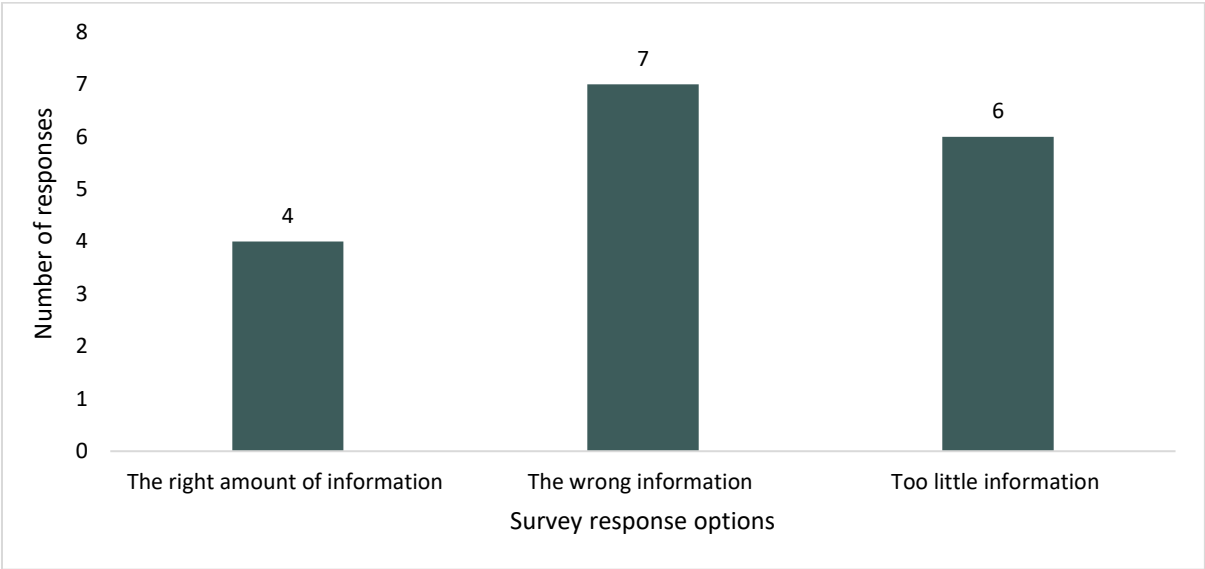
Question 12: How often have you used the Register this year?

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



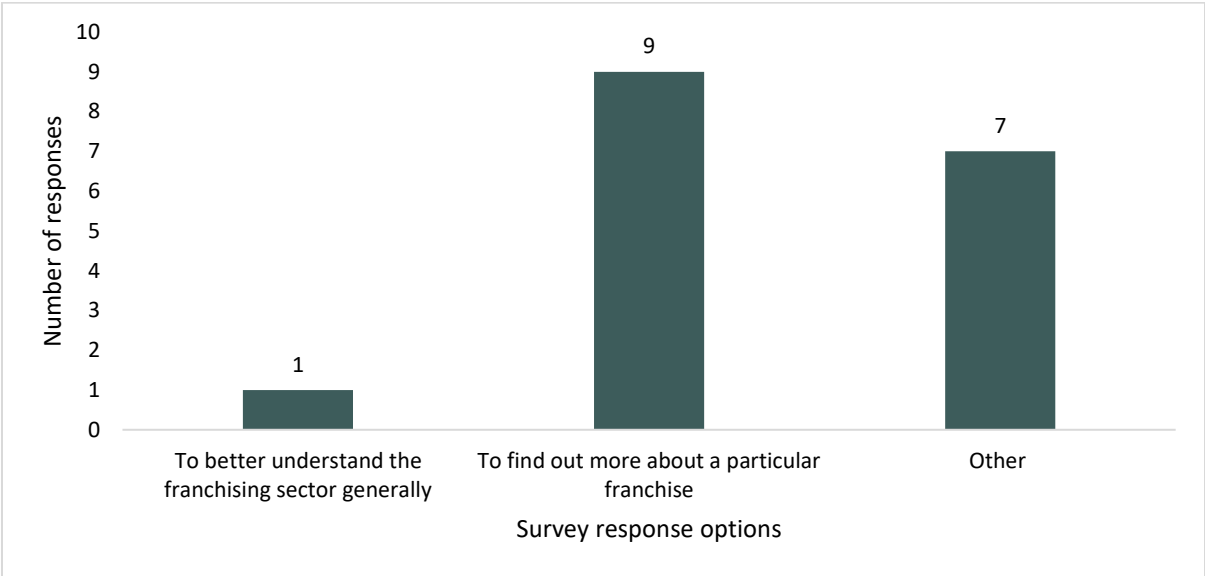
Question 13: Which of the following answers best describes the information on the Register about each franchisor?

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



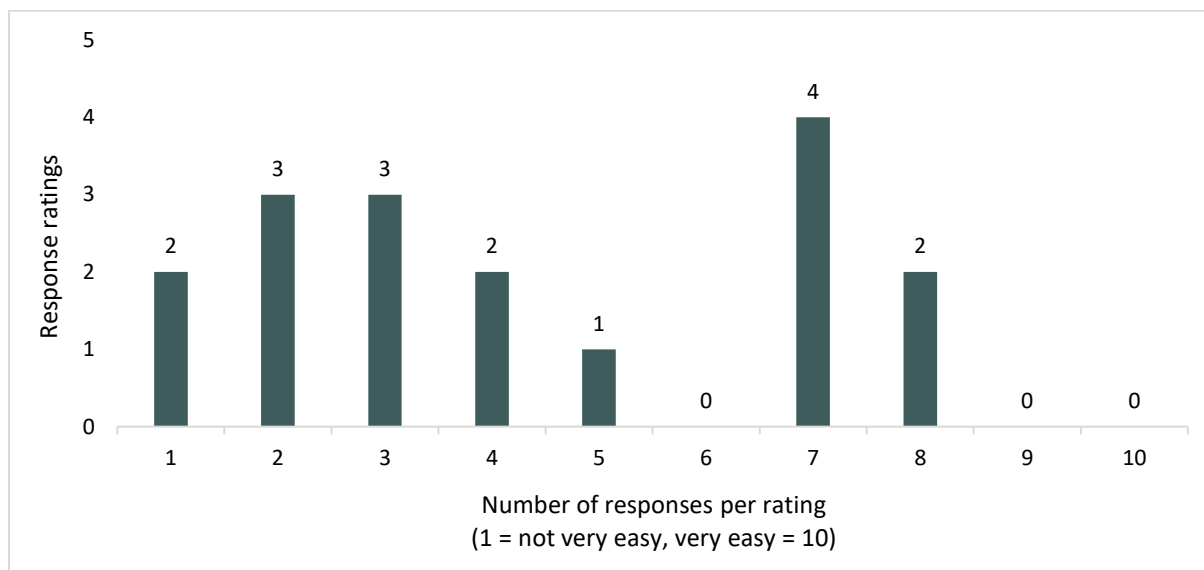
Question 14: Which of the following best describes your main reason for using the Register?

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



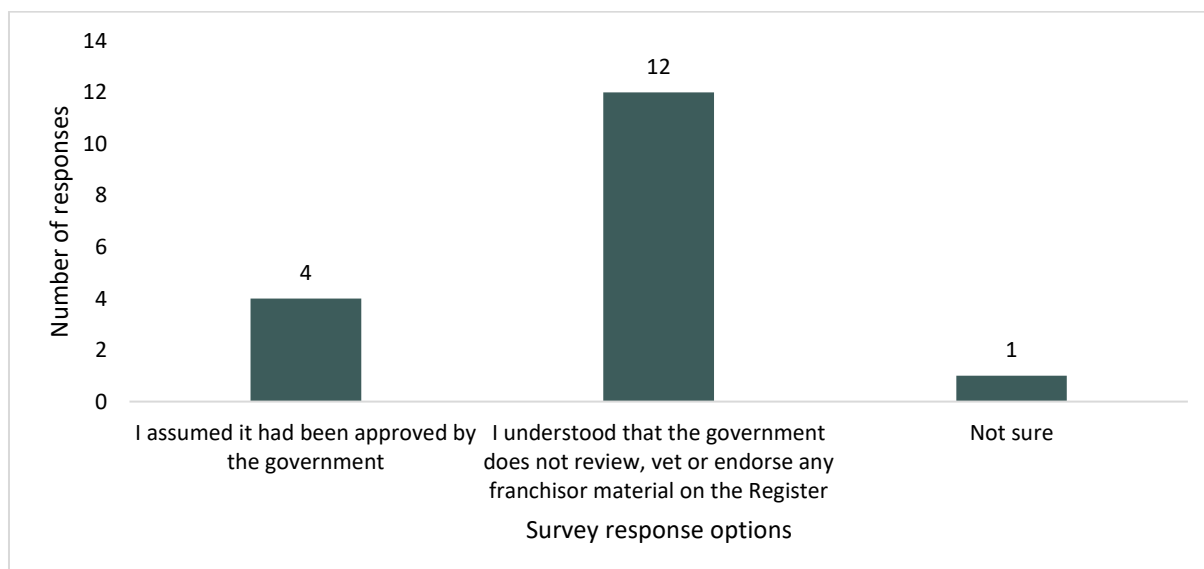
Question 15: How easy was it to compare information about different franchises on the Register? (median = 4.0, mean = 4.4)

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



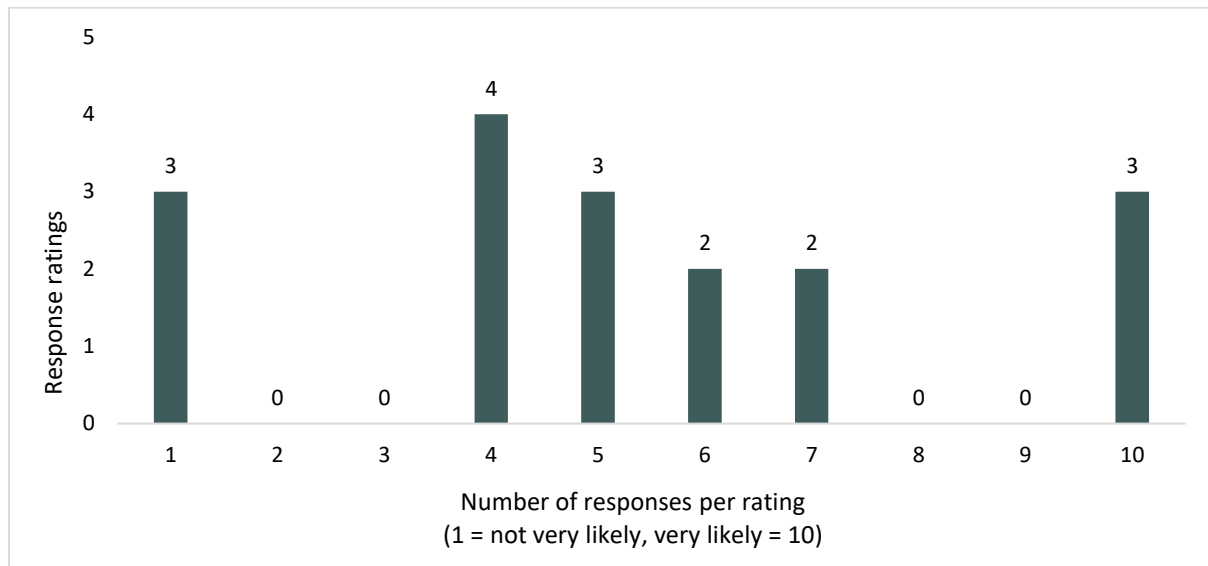
Question 16: How did you interpret the information on the Register?

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



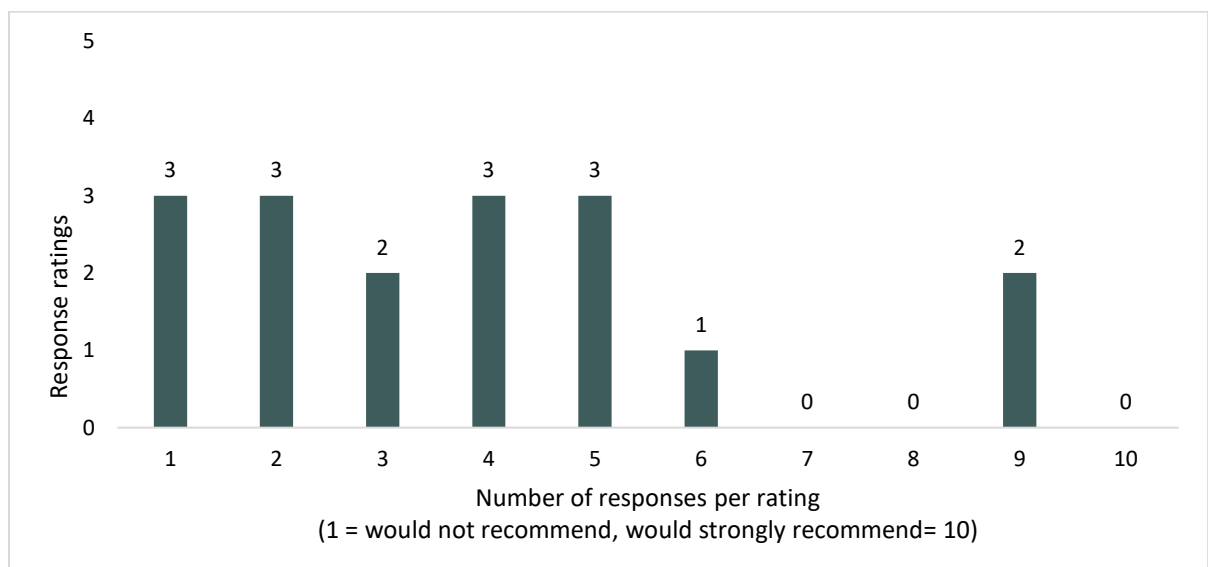
Question 17: How likely would you be to use the Register again? (median = 5.0, mean = 5.3)

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



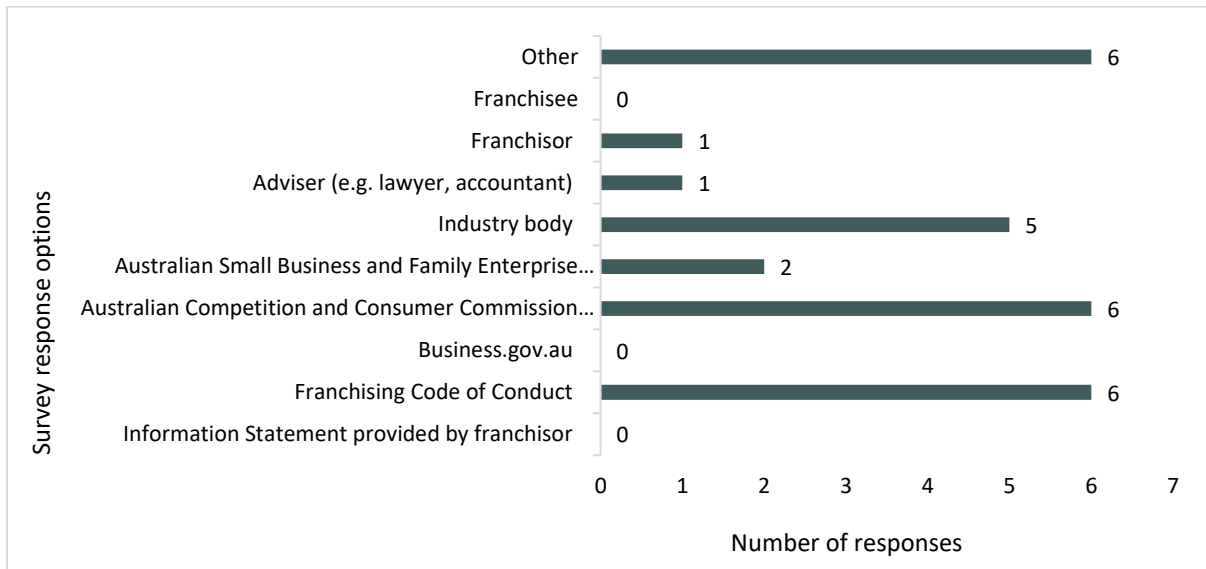
Question 18: How likely would you be to recommend the Register to others? (median = 4.0, mean = 3.9)

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



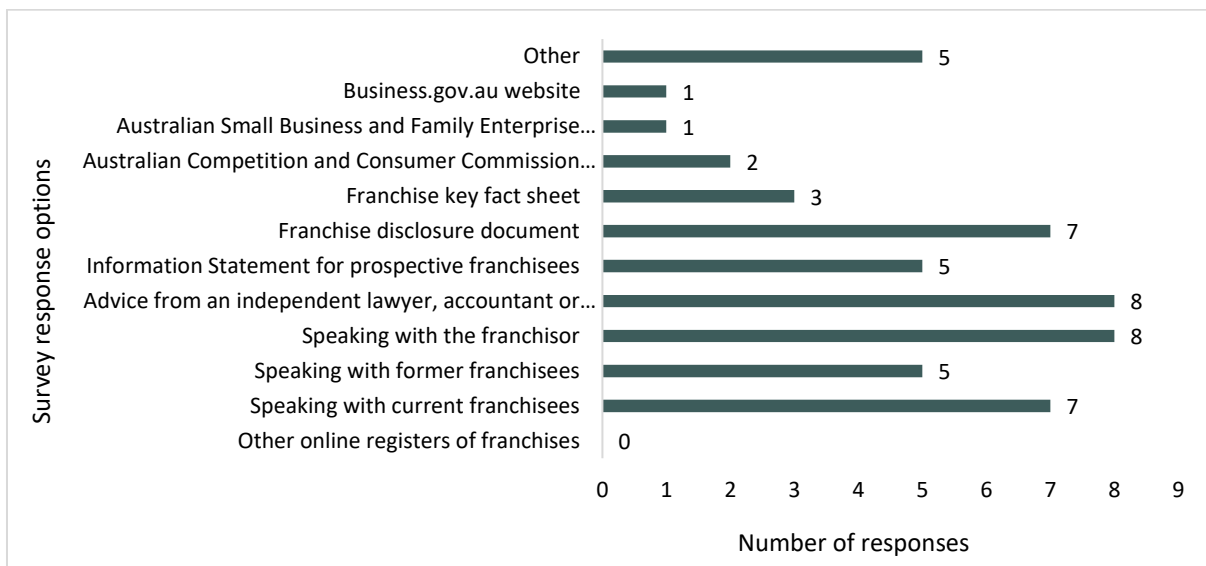
Question 19: How did you learn about the Franchise Disclosure Register? Select all that apply.

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



Question 20: What sources of information other than the Register are you using, or did you use, to decide whether to enter into a franchise agreement? Select all that apply.

Note: this question was not asked of franchisors or franchisor advisors. This explains the low number of responses, noting these groups were the primary survey respondents.



Question 21: Is there any other feedback you would like to provide regarding the Franchise Disclosure Register?

This was a free text field, limited to 1,000 characters. 111 respondents provided a response to the question.

Table 12: FDR survey free text response analysis

Topic	Most common words	Representative responses
Franchise & franchisee dynamics	Franchise, franchisee, register, prospective, franchisees, information, franchisors, disclosure, provide, franchisor	• More information should be required to enable comparison of franchisors
Disclosure & documentation	Information, disclosure, register, franchise, provide, document, fees, process, costs, requirements	• Updating information and using myGov is challenging. • A more user-friendly system for information submission is required.
Franchisors & market information	Franchisees, register, franchisors, information, prospective, franchise, disclosure, business, franchises, like	• The Register provides competitive insights for franchisors and franchisees and needs improvement. • Design of the FDR and some franchisor information makes it hard to compare systems.
Information update & franchisor engagement	Information, update, profile, register, franchisor, franchisors, need, required, current, just	• Some franchisors are not uploading information to the FDR. • Not enough usable information and it is hard to upload all necessary documents.
Disclosure process complexity	Information, disclosure, franchisor, franchisee, franchise, point, FDR, franchisees, key, register	• Complex disclosure documentation and difficulties entering that information into the FDR website. • Suggest simplifying and streamlining of the process.

Appendix D: Australian Bureau of Statistics report



FRANCHISOR BUSINESS DEMOGRAPHICS

Business Register Unit, Statistical Infrastructure Division

November 2023

Summary

1. Treasury asked the ABS to assist with the review by providing any available statistics about this sector. Existing ABS datasets do not include flags or other sources to provide information on franchisors or franchisees. Accordingly, data from the FDR (1,712 profiles) was matched with the ABS' Statistical Business Register to provide insights for the review.
2. As the FDR is quite recent, time series analysis is not possible due to survivorship bias. The FDR includes franchisors who have survived until 2022 or who have started since then, so time series data analysis will not include franchisors who failed before October 2022. Over time, more valuable survivorship data will be possible.
3. The data matching exercise estimates 1,144 grouped franchisor brands. Franchisors self-reported 70,735 franchisees.
4. The most interesting thing of note from this analysis is that 56,875 (80.4% of total franchisees) franchisees are dealing with a franchisor that is large or complex (has at least \$100 million in income, over 200 employees, has at least 100 franchisees or is internationally owned).
5. The FDR, as provided in September 2023, had 1,712 listed franchisors. There were 63 franchisors who did not provide an ABN and 88 ABNs were related to 280 different franchisors. As such it is not a simple one to one match between franchisors and ABNs, which complicates the analysis.
6. Franchisors reported they had 70,735 franchisees (one franchisee may have many locations and as such this is not a count of stores or independent operations).

7. The data is grouped using a hybrid size measure, considering employment, turnover, franchisor and franchisee counts and foreign ownership. Single measures did not accurately represent the full range of franchisors' economic activity. For example, there were many franchisors with no employment but 100+ franchisees, or with no employment but over \$100 million in revenue.
8. This is due to many franchisor groups being part of businesses with complex structures often involving many ABNs, Income Tax Consolidations, GST group reporting and/or other indicators. Thus, the ABN provided is not reflective of all the economic activity of the franchisor groups and as such it was necessary to group related entities and use multiple sizing criteria for grouping.

1.0 Background

1. The FDR became mandatory in October 2022. Any existing franchisors had to register before 31 October 2022. New franchisors intending to enter into a franchise agreement must do so 14 days before entering into this agreement.
2. The FDR is as complete a list as is practically possible of all franchisors in Australia. Given the short period that the FDR list has been operational, any time series analysis is of limited value due to survivorship bias (only franchisors who survived till 31 of October 2022 are included).
3. The FDR provided to the ABS included:
 - franchisor name
 - trading name
 - ABN (if provided)
 - count of corporate owned stores
 - count of franchised businesses
 - total franchisees owned
 - self-coded ANZSIC of the franchisor at the division and subdivision level.
4. The FDR, as provided in September 2023, had 1,712 listed franchisors with:
 - 63 with no ABN provided
 - 88 ABNs related to 280 different franchisors.
5. The franchisors reported they had 70,735 franchisees (where one franchisee may have many business locations).
6. The ABS Business Register is a statistical business register and is used by the ABS to enable the production of economic statistics. It is primarily based on data from the Australian Business Register (ABR) and the Australian Tax Office (ATO). Turnover is estimated from the Business Activity Statement (BAS) related to GST reporting, and employment is primarily estimated from the ATO Pay as You Go (PAYG) reporting system.

7. The ABNs provided to the FDR were linked to the ABS Business Register. This identified franchisors with tens of millions in revenue but no staff, hundreds of franchisees but very little income and many franchisor ABNs had not been registered for GST. This indicates that the complex structures for franchisors often cannot be represented by a single ABN.
8. The ABNs provided to the FDR were often an incomplete representation of the franchisor's economic activity. As such, using a single-dimensional size measure about the provided ABN would be misleading. Therefore, a multi-dimensional approach was implemented to derive a hybrid sizing range using multiple measures including employment, turnover, fording ownership, count of franchisees and related entities.

2.0 Methodology

9. This section describes how ABS cleaned the dataset to create a hybrid size range for the summary data:
 - **Tier 1** – less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees
 - **Tier 2** – is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees
 - **Tier 3** – is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees.
10. A key factor which significantly changed the results was the decision to group franchisors together where there was clear evidence to do so. This was based on:
 - same or similar names
 - same ABN provided
 - ABNs with common ownership on the ABS Business Register
 - company annual reports.
11. A simple process was used to group franchisors. This could be enhanced by more detailed profiling of the franchising groups. This grouping was necessary due to the number of franchisors that were part of related franchise groups. Specifically, the Jims group and Harvey Norman accounted for over 23% of registered franchisors and over 13% of total franchisees.
12. Once created, measures for these groups were aggregated (turnover, franchisee counts, and employment), moving most identified groups into the Tier 3 range. The ANZISC division for a group was based on the most common ANZISC division of the franchisors. The ANZSIC value used was the self-provided ANZSIC from the FDR as it usually represents the activity of the franchisor groups compared to the ANZSIC from the ABS Business Register (which better represents the activity the legal entity is engaged in).
13. The turnover estimate was created using BAS benchmarks, derived from GST reporting. Many of the listed ABNs are in GST groups where one ABN reports for all members of the group. The ABS prorates the turnover across all ABNs in the group based on employment (and other data items). However, as some groups have one ABN in a GST group with all the employees while other ABNs

in the group have no employees, this does not provide an accurate measure of turnover size. For example, one franchisor group with 7 ABNs in a GST group, had 6 ABNs which were non employing. The proration process allocated nearly all the turnover to the employing ABN. By grouping these franchisors, all are included in Tier 3, consistent with the large number of franchisees in their group.

14. Estimated employment was based on the PAYG payment summary data, which is the total count of payment summaries issued in the last financial year (with complex deflation factors to account for staff turnover). Before grouping, 45% of franchisors (770) did not have employment according to the ABN (or lack thereof) provided. Given the count of franchisees for many of these franchisors, it is unlikely to be accurate and is another example of the franchisor ABN not providing a complete picture of the activity of franchisors.
15. The ABS reviewed the list of franchisors with more than 5 franchisees and identified whether they were foreign owned. These franchisors were included in the largest size grouping. This was necessary to avoid many franchisors relating to some of the best-known brands or companies being classified to the lowest size category, when they are known to be large internationally.

3.0 Data analysis

16. The most interesting thing of note from this analysis is that 56,875 franchisees (80.4%) are dealing with a franchisor that is in Tier 3 (has at least \$100 million in income, or over 200 employees, or has a least 100 franchisees, or is internationally owned).
17. Most franchisees are dealing with a substantially larger or more complex organisation than themselves. However, it is still true that after grouping, most franchisors are in Tier 1, the least complex group.

Table 1. Count of franchisors, count of franchisors (grouped) and franchisees by hybrid size measures

Hybrid Sizing Measure	Count of Franchisors	Count of Franchisors (Grouped)	Count of Franchisees	Percentage of total Franchisees
Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees	665	639	4,727	6.7%
Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees	261	225	9,136	12.9%
Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	786	280	56,872	80.4%
Grand Total	1,712	1,144	70,735	100%

18. The report's appendix contains 3 additional tables. Key comments about each are below.

Table 2: Count of franchisors and franchisees by employment range and hybrid size range

- a. Despite the grouping there were still 68 franchisors, which contained 6,098 franchisees (an average of 89 franchisees per franchisor) that were non employing. This indicates that it is likely that we are not capturing the complete activity of those franchisor groups.
- b. 45,144 (63.8%) of franchisees are in franchisor groups with 20 or more employees – a common size range used by state government for 'small businesses'.

Table 3: Count of franchisors and franchisees by turnover range and hybrid size range

- a. There were 169 franchisor groups with no linked income that had 1,749 franchisees. This again demonstrates that the ABNs provided are not accurately capturing the reporting income, at least through BAS reporting. Using Business Income Tax returns may enable more accurate assessment of these records.
- b. There were 41 franchisors in the largest size range that reported turnover of less than \$10 million but included 7,230 franchisees (an average of 176 franchisees per franchisor). \$10 million revenue is the figure used by several ATO rules to define small business. This could indicate multiple things, such as the ABNs provided aren't capturing all the relevant activity, or that turnover is a poor measure of business size. This is true for many industries – it is very common for wholesalers to have \$10+ million turnover but only a handful of employees and very low profit margins, while franchisors may be the opposite of this with no actual products being sold included in their incomes and higher profit margins.
- c. While it is not shown in the table, there was a clear correlation between having higher turnover and employee counts relative to counts of franchisees if the franchise also had corporate owned stores. Most of these businesses are labour intensive and rather than reporting just income from franchisees, these entities are also reporting sales from stores. Any further analysis should split these types of franchisors to enable better comparisons.

Table 4: Count of franchisors and franchisees by ANZSIC Division and hybrid size range

- a. The 3 largest ANZSIC divisions for franchisors and franchisees are Retail Trade (269 and 18,249), Accommodation and Food Services (184 and 7,438) and Other Services (181 and 18,292). Other services are dominated by cleaning services.
- b. Care should be taken when analysing this table – the ANZSICs are self-provided and a review of the top 50 franchisors by ANZSIC shows some unexpected choices. For example, McDonalds being under Food Retailing (Retail Trade) rather than Takeaway Food services or Restaurants (Accommodation and Food Services) does make analysis on this data problematic, and there are many other groups with similar self-reporting choices. (This data is publicly available, and this example does not breach confidentiality).
- c. The ABS Business Register values for these businesses are an improvement in some areas but are often not, as the ABS ANZSIC value often relates to the purpose of the ABN (franchisor) rather than the type of business the franchisee is undertaking.

4.0 Limitations and recommendations

19. There are significant limitations with this dataset and the analysis that is possible:

- a. This analysis was completed under a tight timeline to meet Treasury requirements. If further work is undertaken on this or a similar project in the future, analysis of groupings using ASIC data (ultimate holding companies) will be helpful to identify additional common groups and foreign ownerships. Income tax return data will be beneficial to identify groups and to enable more detailed breakdowns on revenue types to better understand different types of businesses. The analysis and results provided in this report are a best attempt based on simple methods and short time frames and should be considered a basic representation only, given the assumptions that have had to be made.
- b. The information on the FDR is self-provided. The self-provided ANZSIC can be improved through cleaning by an individual trained in ANZSIC coding. Given the count of records and how public the businesses are this is not likely to be a time-consuming task. Cleaning could also include basic rules on business naming conventions.
- c. The use of counts of franchisees as a key metric is simplistic but problematic. Many types of franchisees may be one person businesses (such as cleaning services) while others (such as a McDonalds store) may have 60+ employees. Yet, both count as one franchisee in the current analysis. The lack of ABNs and more detailed data on the franchisees is problematic for more detailed analysis. For example, there is no estimate for total employment by industry, or the ability to see how franchising affects or dominates one industry compared to another. This has affected the size groupings, given total number of franchisees was used as part of the size measure.
- d. As the FDR is quite recent, time series analysis is not possible due to survivorship bias. The FDR only includes franchisors who have survived until 2022 or who started since then, so time series data analysis will not include franchisors who failed before October 2022. Over time, more valuable survivorship data will be possible.
- e. A key desire is to better understand the performance of franchisees relative to their peers – businesses in the same industry who do not use a franchise model. To do this effectively a population of all businesses who attempted to become a franchise business would be required. A possible first step would be to require the FDR to include a list of all new franchisees (including ABN). Alternatively, an investigation could target a representative sample of franchisor businesses seeking franchisee information, including a list of all ABNs for a specific period (including those no longer in operation).



Appendix: Data tables 2 to 4

Table 2. Count of franchisors and franchisees by employment range and hybrid size range

Count of Franchisors						
Hybrid Sizing Measure	Non Employing	0 to 4	5 to 19	20 to 199	200+	Total
	no.	no.	no.	no.	no.	no.
Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	264	267	108			639
Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	29	39	63	94		225
Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	68	20	32	87	73	280
Grand Total	361	326	203	181	73	1,144
Count of Franchisees						
Hybrid Sizing Measure	Non Employing	0 to 4	5 to 19	20 to 199	200+	Total
	no.	no.	no.	no.	no.	no.
Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	1,331	2,188	1,208			4,727
Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	1,436	1,816	2,873	3,011		9,136
Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	6,098	3,615	5,026	18,001	24,132	56,872
Grand Total	8,865	7,619	9,107	21,012	24,132	70,735

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Table 3. Count of franchisors and franchisees by turnover range

Count of Franchisors (Grouped)									
Hybrid Sizing Measure	no.	no.	no.	no.	no.	no.	no.	no.	no.
	No linked income	\$0 to \$50k	\$50k to \$200k	\$200k to \$2 mil	\$2 to \$5 mil	\$5 to \$10 mil	\$10 to \$100 mil	\$100 mil+	Total
Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	156	27	80	287	66	23			639
Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	9			61	47	39	66		222
Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	4		3	15	7	12	40	199	280
Grand Total	169	27	83	363	120	74	106	199	1,141
Count of Franchisees									
Hybrid Sizing Measure	no.	no.	no.	no.	no.	no.	no.	no.	no.
	No linked income	\$0 to \$50k	\$50k to \$200k	\$200k to \$2 mil	\$2 to \$5 mil	\$5 to \$10 mil	\$10 to \$100 mil	\$100 mil+	Total
Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	673	101	398	2,388	872	295			4,727
Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	444		114	2,509	2,001	1,608	2,396	64	9,136
Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	632	147	452	2,533	775	2,691	9,493	40,149	56,872
Grand Total	1,749	248	964	7,430	3,648	4,594	11,889	40,213	70,735

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Table 4. Count of Franchisors and Franchisees by ANZSIC Division and hybrid size range

ANZSIC DIV – Self Selected	Count of Franchisors (Grouped)			Total
	Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	
	no.	no.	no.	no.
ACCOMMODATION AND FOOD SERVICES	124	28	32	184
ADMINISTRATIVE AND SUPPORT SERVICES	15	3	5	23
AGRICULTURE, FORESTRY AND FISHING	NP	NP	NP	3
ARTS AND RECREATION SERVICES	65	18	11	94
CONSTRUCTION	30	11		41
EDUCATION AND TRAINING	44	12	4	60
ELECTRICITY, GAS, WATER AND WASTE SERVICES	NP	NP	NP	7
FINANCIAL AND INSURANCE SERVICES	7	6	11	24
HEALTH CARE AND SOCIAL ASSISTANCE	20	12	6	38
MANUFACTURING	6	6	4	16
OTHER SERVICES	124	33	24	181
PROFESSIONAL, SCIENTIFIC AND TECHNICAL SERVICES	25	9	3	37
PUBLIC ADMINISTRATION AND SAFETY	NP	NP	NP	2
RENTAL HIRING AND REAL ESTATE SERVICES	46	16	34	96
RETAIL TRADE	114	61	94	269
TRANSPORT, POSTAL AND WAREHOUSING	6	3	6	15
WHOLESALE TRADE	5	6	43	54





ANZSIC DIV – Self Selected	Count of Franchisees			
	Less than \$10 million turnover, less than 20 employment, not foreign owned and less than 30 franchisees.	Is one of \$10 million to \$100 million in turnover, 20 to 199 employment, not foreign owned and between 30 and 100 franchisees.	Is at least one of: \$100+ million in turnover, 200+ employment, foreign owned or over 100+ franchisees	Total
	no.	no.	no.	no.
ACCOMMODATION AND FOOD SERVICES	726	1,038	5,674	7,438
ADMINISTRATIVE AND SUPPORT SERVICES	143	78	1,970	2,191
AGRICULTURE, FORESTRY AND FISHING	NP	NP	NP	253
ARTS AND RECREATION SERVICES	566	809	5,724	7,099
CONSTRUCTION	306	516	0	822
EDUCATION AND TRAINING	319	537	462	1,318
ELECTRICITY, GAS, WATER AND WASTE SERVICES	NP	NP	NP	177
FINANCIAL AND INSURANCE SERVICES	53	301	2,567	2,921
HEALTH CARE AND SOCIAL ASSISTANCE	123	405	1,089	1,617
MANUFACTURING	45	175	275	495
OTHER SERVICES	987	1,388	15,917	18,292
PROFESSIONAL, SCIENTIFIC AND TECHNICAL SERVICES	176	489	339	1,004
PUBLIC ADMINISTRATION AND SAFETY	NP	NP	NP	48
RENTAL HIRING AND REAL ESTATE SERVICES	310	623	2,649	3,582
RETAIL TRADE	835	2,358	15,056	18,249
TRANSPORT, POSTAL AND WAREHOUSING	44	83	1,653	1,780
WHOLESALE TRADE	50	257	3,142	3,449

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Analysis of Franchise Disclosure Register

Prepared for Franchise Review (Treasury) – October 2023

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