



Australian Government

Department of Industry, Science,
Energy and Resources

Regulation Impact Statement

Changes to the Regulatory Framework Applying to the Franchise Sector

August 2020

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1. Executive Summary

The franchising sector is an important contributor to the Australian economy. Franchising is underpinned by the relationship between franchisor and franchisee. This relationship is directly regulated by the Franchising Code and the broad protections available in the Australian Consumer Law.

Despite existing interventions, there is widespread evidence that problems in the relationship between franchisees and franchisors continue. The PJC heard evidence that franchisees are not always sufficiently informed prior to entering into a franchise agreement, franchisors continue to engage in poor conduct, and existing mechanisms to support enforcement, exit and dispute resolution do not go far enough to address power imbalance and problematic conduct of franchisors.

A range of options for regulatory improvements is identified in this Regulation Impact Statement (RIS) to inform the future direction of the regulation of franchising. This RIS concludes that a package of regulatory and non-regulatory reforms, while imposing low to moderate additional regulatory burden on franchisors, would result in an overall net benefit.

2. Background

2.1 The franchising sector

Franchising is a popular business model, and makes a significant contribution to the Australian economy. There are approximately 1,240 franchise brands in Australia with 95,600 franchise establishments, providing employment for approximately 580,000 people. The sector's estimated revenue is \$170.5 billion in 2019-2020.¹

The franchising business structure is used in a diverse range of industries – ranging from large accommodation providers to garden maintenance businesses and everything in between. There is also a diversity in the approach to the franchisor-franchisee relationship in individual systems. In addition, the changing economic environment – such as the generally tough retail environment, the emergence of the gig economy and the growth of alternative models for self-employment, and more recently the COVID-19 pandemic – have created challenges for the sector.

In Australia, around 90 per cent of franchisors, and almost all franchisees are small businesses.² Franchise systems involve a franchisor with experience in operating the brand, an understanding of the market and access to resources. Franchisees by comparison are likely to be smaller operators, without the same business knowledge or experience, and are often from a culturally and linguistically diverse background. Sources suggest many franchisees enter into franchising from wage-dependent employment.³

2.2 Current regulatory framework

In Australia, the relationship between franchisor and franchisee is regulated primarily by the Franchising Code. The Franchising Code is a mandatory industry code prescribed by regulation under Part IVB of the *Competition and Consumer Act 2010* (CCA).

¹ IBISWorld, Franchising in Australia, Industry Report X0002 (July 2020).

² Franchise Council of Australia's submission to the PJC, page 5.

³ Franchise Law Review, page 101, 2018 *Law Business Research Ltd*.

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The mandatory Franchising Code was first introduced in 1998 to promote positive relationships in the franchising sector. Since 1998 the Franchising Code has undergone a number of policy reviews and legislative changes.⁴ The Franchising Code was most recently revised with effect from 2015. Key changes include a requirement for franchisees and franchisors to act in good faith and the introduction of financial penalties for breaches of key provisions of the Franchising Code.

In addition to the Franchising Code, participants in the sector are also subject to the general laws governing business relationships and fair trading in Australia. These laws include prohibitions on unconscionable conduct, false or misleading representations, and the regulation of unfair contract terms in standard form contracts under the Australian Consumer Law. Some of the issues faced by the franchising sector are unique to the sector while others are faced by small businesses in general.

Changes to broader economic policy settings and laws are relevant to the franchising sector. For example, since the Franchising Code was amended in 2015:

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

Industry compliance with the Franchising Code is overseen by the ACCC, which has a range of enforcement options. These options include issuing infringement notices and taking court action seeking pecuniary penalties.

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

Parties to a dispute are able to approach ASBFEO for assistance with the Franchising Code mediation process. The parties to a franchise agreement are also able to take action through the courts to resolve disputes or pursue breaches of the Franchising Code.

2.3 The Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the franchising sector, and the *Fairness in Franchising* report

On 14 March 2019, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) handed down its *Fairness in Franchising* report, making 71 recommendations to improve the operation and effectiveness of the franchising sector. This included a recommendation that the Government form a Franchising Taskforce to consider a number of the recommendations made in the report.

On 21 June 2019, the Government announced it had agreed to establish the Franchising Taskforce.⁵ The Franchising Taskforce was comprised of senior officials within the Department of the Treasury, the Department of Industry, Science, Energy and Resources, and the Department of the Prime

⁴ *Fairness in Franchising* report, Appendix 3, pages 319-320.

⁵ See Media Release, *Building a fair, effective and accountable franchising network*, 21 June 2019, <https://ministers.employment.gov.au/cash/building-fair-effective-and-accountable-franchising-network>.

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Minister and Cabinet and was tasked with providing advice to Government on the recommendations in the PJC's *Fairness in Franchising* report.

The Franchising Taskforce consulted on the PJC's recommendations, and principles underpinning franchising regulation and that consultation is reflected in this RIS.

3. What is the problem?

There are widespread problems in the franchising sector. These have been documented in the PJC's comprehensive *Fairness in Franchising* report, which was informed by a 12-month inquiry and over 400 submissions. Consultation undertaken by the Franchising Taskforce built on the work of the PJC.

The ACCC oversees enforcement of the Franchising Code and the Australian Consumer Law, and confirms that there are widespread problems in the sector, warranting robust regulatory reform. ASBFEO has a role in helping franchising parties in dispute and also supports regulatory reform.

The social impacts of problems in this sector include significant mental health impacts and relationship breakdowns. The economic impacts include significant direct financial losses incurred by franchisees⁶, and secondary impacts in relation to employee entitlements and competition.

Underlying these problems are franchisees entering into franchise agreements without adequate information, evidence of poor franchisor conduct, and insufficient enforcement and dispute resolution mechanisms. These issues are discussed below.

Prospective franchisees are not always well informed before buying a franchise

Evidence shows many franchisees are not well informed before making the decision to buy a franchise. Disclosure documents are difficult to comprehend, and do not contain all critical information relevant to entering into a franchise agreement. The reliability of information provided may also be difficult for a potential franchisee to assess and they might be unaware what is crucial for their decision making. Reliable information, particularly financial information (capital expenditure, supplier rebates, financial performance and leasing), assists prospective franchisees to conduct due diligence and compare different franchise offerings.⁷ A lack of transparency in the use of marketing funds has also been highlighted as a problem, which has been shown to lead to reduced trust and disputes.

Franchisees can also be affected by 'optimism bias', where they are reluctant to face the downside of an investment to which they have become emotionally attached. For poorly informed or overly optimistic franchisees, the cooling off period available to exit the franchise agreement is important. The current seven-day cooling off period is insufficient, and in some cases (for example transfers, extensions and renewals) franchisees receive no cooling off period at all.

Issues relating to inadequate disclosure, transparency and reliability of information are further compounded when franchisees do not seek professional advice. The ACCC found that 40 per cent of prospective franchisees did not seek any independent professional advice before entering a franchise agreement.⁸ Concerns have also been raised about the adequacy of educational material to inform and assist prospective franchisees.

Some franchisors behave poorly

The franchising sector is very diverse. Across the estimated 1,240 franchise systems operating in Australia, the ACCC receives more than 450 reports a year.⁹ Particular concerns have been raised in

⁶ See discussion on the limitations of franchising data below

⁷ See example cited at page 65 of the PJC *Fairness in Franchising* report, provided by 7-Eleven stores.

⁸ See, for example, ACCC's *Disclosure practices in food franchising* report. This report found that 40 per cent of prospective franchisees did not seek any independent professional advice before entering a franchise agreement.

⁹ The ACCC report *Small Business in Focus*, showed that for the 12 months to 31 December 2019, the ACCC received 465 reports relating to franchising. This was an increase from the previous 12 month period in which

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relation to retail food franchising, with evidence of systemic poor disclosure practices.¹⁰ However problems are widespread, with the ACCC taking action against franchisors in a range of other sectors alleging breaches of the Franchising Code and the Australian Consumer Law.¹¹ This confirms evidence provided to the PJC and the Franchising Taskforce highlighting instances of egregious conduct by franchisors. It also confirms the outcomes of reviews into automotive franchising which highlighted problematic conduct by automotive franchisors in relation to dispute resolution, capital expenditure and end of term arrangements.¹²

Current regulation and penalties have not deterred poor conduct

The current penalties for breaches of the Franchising Code have not prevented poor conduct from franchisors. This is despite the ACCC making small business, and compliance with the Franchising Code of Conduct, a Compliance and Enforcement Policy and Priority in recent years.¹³

Evidence has been submitted that the scope and quantum of current penalties is insufficient to encourage compliance and some franchisors may factor the cost of penalties into their cost of doing business.¹⁴ There have also been allegations of franchisors not mediating in good faith, which would be considered a breach of the Franchising Code. This evidence around non-compliance supports the ACCC's findings of systemic poor disclosure practices in food franchising.¹⁵

Non-compliance undermines the intent of industry codes to raise standards of business conduct by guarding against misconduct and opportunistic behaviour. In order for broader improvements in disclosure and the Franchising Code to be effective, there needs to be a culture of compliance across the sector.

Exit and dispute resolution processes for franchisees are insufficient

Small business franchisees, unlike independent small businesses, are entirely dependent on a functional relationship with their franchisor to continue in business. Accessible, affordable and effective dispute resolution processes are important to resolve disagreements between franchisors and franchisees.

Many franchisees are not aware of available dispute resolution processes and the PJC noted that the Franchising Code does not provide for conciliation or arbitration to facilitate dispute resolution outside of court in cases where mediation fails.

405 reports were received. More detailed information on these complaints, such as the breakdown of issues by industry sector, is not reported. See discussion on limitations to franchising data below.

¹⁰ ACCC *Disclosure practices in food franchising*, August 2019 report. Compliance in this sector was targeted because '[t]he ACCC receives more franchising code related reports from café, restaurant and take-away food franchisees than any other sector' (Media Release, *ACCC to focus on franchisors; disclosure in the food services sector*, 7 February 2019).

¹¹ Recent ACCC action has been taken against Bob Jane Corporation Pty Ltd, Geowash, Ultra Tune and Jump Swim Schools. Details on www.accc.gov.au.

¹² Department of Industry, Science, Energy and Resources, *Regulation Impact Statement: Franchise relationships between car manufacturers and new car dealers*, February 2020.

¹³ <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities#2020-priorities>

¹⁴ The maximum penalty for breach of an industry code provision is 300 penalty units (currently \$66,600). These amendments also allowed for the ACCC to issue infringement notices where it has reasonable grounds to believe a person (or body corporate) has contravened a civil penalty provision of an industry code. Infringement notice amounts are 50 penalty units (currently \$11,100) for a body corporate and 10 penalty units (currently \$2,220) in any other case.

¹⁵ ACCC *Disclosure practices in food franchising*, August 2019 report.

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It is also unclear whether existing provisions in the Franchising Code enable multi-party mediations, particularly where the franchisor seeks to avoid multi-franchisee mediation.

Franchisees wishing to exit the system due to hardship or faced with poor conduct from the franchisor are not well supported by the current Franchising Code which only supports a process for franchisor-initiated exits. The treatment of goodwill at the point of exiting a franchise agreement and the restraint of trade clauses prohibiting franchisees pursuing legitimate business ventures after exiting a franchise have also been identified as concerns for franchisees.

Limitations to franchising data

The availability of statistics on the franchising sector is limited. For example, aggregate data on the financial losses incurred by franchisees and complaints data by industry within the franchising sector are not available. However, consistent evidence in submissions to the PJC and the Franchising Taskforce, and the problems illustrated in the *Fairness in Franchising* report, provide insight into the level of financial loss and the spread of issues in the sector.

For example, the PJC heard from a franchisee whose family lost in excess of \$800,000 due to their involvement with their franchisor. The Franchising Taskforce heard similar stories, including from a former franchisee who stated that her and her husband 'lost everything [they] ever worked for' due to their franchisor and were left with a \$500,000 debt.

Although the ACCC does not report on the industry breakdowns of franchising complaints, problems in the franchising sector appear to be widespread. Submissions to the PJC and Franchising Taskforce indicate evidence of poor behaviour from a variety of sectors including food and non-food retailing, transportation, automotive and fuel retailing.

4. Why is government intervention necessary?

The Government introduced the mandatory Franchising Code in 1998. Since then it has been revised a number of times to address issues in the sector. The fair trading provisions of the Australian Consumer Law are also relevant to franchisees and franchisors. The PJC report and work of the Franchising Taskforce have confirmed that further reform is needed to deter systemic non-compliance, improve transparency and prevent poor franchisor conduct.

The impact of poor behaviour can be severe

While the most egregious behaviour is not widespread, the consequences of poor franchisor conduct have been devastating for some franchisees and undermined confidence in the franchising business model.

The PJC and Franchising Taskforce heard directly from current and former franchisees about the significant personal and financial impacts arising from poor practices in the sector. This included bankruptcies, mental health issues and marriage breakdowns, noting that many franchisees businesses are run as family businesses.

At the end ... my life no longer resembled anything I had previously known before my involvement with franchising. I am separated from my husband and have lost in excess of \$280 000. It is almost impossible to recover from this amount of financial loss with the time I have left before I retire. I will then become a burden on the tax paying public.¹⁶

The impact of poor franchisor behaviour has also extended beyond franchisees. One example is the underpayment of employees. Since 2016-17, the Fair Work Ombudsman (FWO) has received more than 4,500 anonymous reports of underpayment of staff that relate to franchises (or just over 11 per

¹⁶ Submission 184 to the PJC inquiry.

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cent of all anonymous reports received during that period), with more than half of these reports related to the hospitality industry. In March 2019 the Migrant Workers Taskforce found that some franchising models lead to the underpayment of wages by franchisees.¹⁷

Problems in the franchising sector can also undermine fair competition with other businesses. Independent businesses may be unable to compete with lower wages, or unviable prices set by the franchisor. In the case of the latter, franchisees may continue to trade because they are unable to exit their franchise agreements. This may in turn have broader economic and consumer impacts.

Franchisees face unique challenges

In addition to the general issues faced by small businesses, franchisees face unique challenges.

In addition to usual business overheads, franchisees pay fees to the franchisor. The COVID-19 economic downturn has further exacerbated cost pressures, with some franchisors continuing to charge franchise fees despite their businesses being forced to close, such as gym operators, or suffering significant losses in trade, such as in the food and personal services sectors.

Other financial controls include the franchisor having control over the prices that the franchisee charges customers, mandating capital investments, mandating suppliers used and the cost of supplies.

Franchisees can be limited in responding to market conditions, when compared to independent small businesses. COVID 19 has seen many examples of small businesses pivoting to take up new opportunities, but franchisees are often constrained in this regard.

Franchisors can often make unilateral changes to the franchise agreement and business model. While there are may be legitimate reasons to do this, it can change the basis on which the franchisee made their investment decision. For example, some franchisees described how their franchisor changed food products being sold from 'fresh' to 'frozen' products.

Compared to independent small businesses, franchisees often face additional challenges winding down or exiting an unsuccessful business venture. They are more likely to continue as an unprofitable business than independent businesses. Allocative efficiency in the economy is harmed when a franchisee is unable to operate a viable business but also unable to exit. Resources that could operate more productively elsewhere are 'tied up' in an unviable operation. One franchisee in submitted to the PJC Inquiry on her experiences exiting the franchise system:

"I was nearly five years locked into a business I couldn't sell, couldn't walk away from and that no one wanted. Three years later I had seven failed attempts at selling my business".¹⁸

Another submission commented on the difficulties in selling their food retail business.

...we wanted to sell the business but there were no buyers due the high exit and entry costs... In the end, we had to make the hard decision of walking away from the business and losing everything. Worked extra-long hours and felt trapped in the system, impacting our health and family life... We personally have never encountered the stress and strain as we felt by joining this franchise. We have lost almost \$800,000 plus our health ... ".¹⁹

¹⁷ Report of the Migrant Workers' Taskforce, https://www.ag.gov.au/sites/default/files/2020-03/mwt_final_report.pdf, p. 37

¹⁸ Submission 32 to the PJC inquiry.

¹⁹ Submission 185 to the PJC inquiry.

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While the interests of a franchisor and franchisee can be aligned, this is not always the case. An example is where the franchisee may be required to acquire supplies from a third party that provides a rebate or incentive to the franchisor. The franchisee may be incentivised to choose a supplier who offers the best rebate to the franchisor, instead of providing the best value goods. In other cases, the franchisor's business model may be premised on 'churning and burning', where the franchisee's success is irrelevant to (or even opposed to) the franchisor's success.

"Franchise sellers foment unwarranted franchise churn which can cost franchisees their life's savings, their homes, sometimes their marriages and even their lives through suicide."²⁰

Finally, there is often a disparity in resources between franchisor and franchisee which is acutely felt in the context of dispute resolution (including access to legal remedies for franchisees).

Reform is required to level the playing field

The problems observed by the PJC, ACCC and ASBFEO have established that there is a case for reform. Submissions to the PJC Inquiry, as well as consultations by the Franchising Taskforce, indicate that there is broad stakeholder support for further Government action in this sector.

Noting that the Franchising Code has been subject to successive reviews,²¹ some stakeholders have argued for fundamental changes to the franchising relationship. The ACCC has argued that the Franchising Code, even in an amended form, will never be adequate to address the systemic issues in the sector, and that serious consideration should be given to an ex-ante regulatory model, such as a licensing regime. In its submission to the Taskforce's consultation process, the Australian Association of Franchisees suggested that franchisees should be considered co-investors, with protections similar to those provided to shareholders.

The following section describes policy options being considered to address problems in franchising.

²⁰ Submission 27 to the PCJ inquiry

²¹ See *Fairness in Franchising* report, pages 16-17.

5. What policy options are being considered?

5.1 Option 1: Status Quo

5.1.1 What does this option involve?

Under this option, there would be no changes to the Franchising Code or the enforcement framework in the CCA. No other action would be taken in response to the PJC report recommendations or following the work of the Franchising Taskforce. Franchising participants would continue to be subject to the existing provisions in the Franchising Code as well as the general provisions of the CCA and ACL. The need for change could be re-examined at a future point.

5.1.2 What are the costs and benefits of this option?

The major benefit of this option is that there would be no additional regulatory impact on the franchise sector. Noting that the sector has been adversely affected by the economic downturn caused by COVID-19, franchisors in particular would likely benefit from not incurring transitional and ongoing compliance costs.

This option also provides a longer timeframe to evaluate the effectiveness of the changes to the Franchising Code that took effect in 2015. Noting that the average term of a franchise agreement is around five years, and the PJC inquiry took place across 2018-19, it is possible that the full effect of those changes was not reflected in evidence considered by the PJC.

However, not addressing known problems in the sector is likely to result in continuation of the significant negative social and economic impacts. Ongoing disputes and dissatisfaction will draw resources away from more productive economic pursuits, with continuing low confidence in the franchising business model. Poorly informed franchisees may continue to over value franchise opportunities. Non-compliance is expected to continue. Dispute resolution will continue to be difficult and expensive, with resources devoted to dispute resolution not available for more productive outcomes.

On balance, noting that the regulatory impacts associated with reform are low-moderate, the costs associated with this option outweigh the benefits.

5.2 Option 2: Regulatory reforms to the franchising sector

5.2.1 What does this option involve?

Under this option, the Government would implement the following regulatory measures to address the problems outlined in section 3 of this document.

Reforms to better inform franchisees and improve transparency

A public register of franchisors

Under this option, a public register of franchisors would be established by the Government. All franchisors would be required to provide information to the register. In addition to improving transparency for franchisees, the register would assist the ACCC in its enforcement role, and improve the information available to government about the franchising sector. Consultation will inform the design and implementation of the register.

Stakeholder views

A register may address a range of issues in the franchising sector. For example, a register could increase transparency by allowing prospective franchisees to compare different franchise systems and make a more informed decision before committing to a particular system or brand. The AAF proposed that franchisors, franchisees and franchisee

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associations should be registered, and that franchise agreements and disclosure documents should be lodged. The FCA also supported registration with updated documentation being provided as it felt this would assist the ACCC in its enforcement role, build a culture of transparency and improve confidence in the sector.

Industry associations such as MTA Queensland suggested a public register could also lift standards across the sector by incentivising franchisors to ensure their conditions are competitive, as well as increasing the Government, regulators' and academics' knowledge of the franchising sector. A more robust model was also supported, including registration of all franchisors and all individual franchising arrangements.

Some stakeholders raised concerns that a register may require the disclosure of commercial-in-confidence information to the detriment of the franchising business model. Franchisors have highlighted concerns that a public register would impose an additional compliance burden.

Most significantly, some stakeholders (including the ACCC) have raised concerns that a register could lead some prospective franchisees to believe that the franchise system and any documents or statements on the register have been vetted and can be relied upon. This may, in turn, result in reduced due diligence by prospective franchisees.

Submissions in response to the Taskforce's earlier issues paper showed that there was general support for a registry function amongst stakeholders, with a number of options suggested about who should host it, what information should be available on it and in what form. Under this option, the Government would consult further on the final design of the Register.

A Key Disclosure Information Fact Sheet containing information that is taken from disclosure documents

Under this option, the Government would design a new mandatory Key Disclosure Information Fact Sheet in consultation with the franchising sector to improve and simplify upfront disclosure, highlight key information, and assist franchisees to understand obligations and the risks associated with entering a particular franchise agreement. Further consultation would be conducted on the design of the Fact Sheet.

Stakeholder views

Submissions to the consultation paper showed there was a general consensus amongst stakeholders that the provision of *more* information was not necessarily desirable. Rather, the focus should be on appropriate information being provided in a concise form, including relevant leasing information. Many stakeholders stated that current disclosure is too complex and needs to be made simpler and more relevant.

Electronic and hard copy disclosure documents

Under this option franchisors would be required to provide disclosure documentation in electronic form. Having access to an electronic copy would allow prospective franchisees to more easily share disclosure documentation with relevant professional advisors and more easily search for information.

Stakeholder views

Submissions to the consultation paper process showed that there was general support for electronic disclosure.

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Separate information statement

Under this option it would be made clear the information statement (Annexure 2 of the Franchising Code) should be provided as a separate document to the rest of the disclosure material. This change is intended to make it more likely the information statement will be read before the prospective franchisee commits to entering the agreement.

Stakeholder views

Stakeholders have not raised any significant objections to this recommendation.

Provision of the ACCC's Franchisee Manual to prospective franchisees

A franchisor would be required to provide a prospective franchisee with the ACCC's Franchisee Manual when it first provides the disclosure document.

Stakeholder views

Concerns were not raised by stakeholders in relation to this recommendation by the PJC and is expected to have only a most minimal regulatory burden on franchisors.

Financial disclosure in disclosure document

Under this option, the Government would amend the Franchising Code so that any financial information must be part of the disclosure document (and not provided separately).

Stakeholder views

No significant concerns were raised about the inclusion of financial information, where provided, in the disclosure document.

Increase transparency around retail leasing

Under this option, the Government would implement technical changes to clause 13 of the Franchising Code, to increase transparency surrounding retail leases, subject to consultation with the sector to ensure there are no unintended consequences. Franchisors will not need to provide documents they do not possess.

Stakeholder views

Franchisors have indicated that site negotiation can take a significant period of time, such that providing franchisees with a right to 'cool off' until a site is formally agreed (including the cost) would see the franchisor faced with an extended period of uncertainty. Further, where a franchisor signs a head lessee and then the franchisee utilises their cooling off right, this may leave the franchisor with a premises, but no franchisee to run the business. However, franchisees raised concerns that they cannot make reasonable assessments of the value (including costs, obligations, benefits and risks) of a franchise business without knowing the terms of the lease.

Improved disclosure around supplier rebates

Under this option, the Government would amend the Franchising Code to require franchisors to disclose information on supplier rebates, commissions and other payments and to disclose whether a master franchisor controls and/or receives rebates from suppliers.

Stakeholder views

Submissions to the consultation paper process showed that stakeholders did not agree about the extent of disclosure of supplier rebates and whether third line forcing could be used to exploit franchisees. There was considerable support however for the amount of rebates received to be included as a line in franchisors' profit-and-loss statement. A number

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of franchisors argued that the unintended consequences of regulating rebates could be standardised pricing and reduced incentives to negotiate better deals.

Extend cooling off and parameters to trigger start of cooling off period

Under this option, the Government would amend the Franchising Code to allow a franchisee to terminate any and all arrangements between the franchisor and franchisee at any time up to 14 days after the last of the following have occurred:

- a franchise agreement has been signed;
- a payment has been made by the franchisee to the franchisor;
- the required disclosure documents set out in the recommendations in Chapter 6 of the report have been received by the franchisee, within the required disclosure period; and
- where the franchisor is the lessor or an associate of the lessor, the franchisee has received a document setting out the terms of the lease provided that the final lease is substantially similar to the terms provided.

Stakeholder views

Stakeholders have stated that the cooling off period is only beneficial if there is adequate and transparent disclosure of the costs involved. Stakeholders did not support mandating the provision of a signed lease as a condition of triggering the cooling off period due to the significant risk and difficulties put on the franchisor in doing so. Instead, there was considerable support to replace that condition with the requirement to provide of the terms of the lease.

Cooling off rights extended to transfers

Under this option, cooling off rights would be extended to the transfer of an agreement to a new franchisee and where the franchisee enters a substantially new agreement with the franchisor (a deemed transfer) but not to renewals or extensions.

Stakeholder views

There was general support for the view that a new franchisee should not be disadvantaged because they are purchasing from another franchisee, as opposed to the franchisor.

Amend the relevant clauses of the Franchising Code to apply recent automotive franchising changes relating to capital expenditure

The Government recently amended the Franchising Code to strengthen the right of franchisees in the automotive sector when a franchisor requires a franchisee to make a significant capital expenditure. Those amendments will be expanded to apply to the broader franchising sector.

This means that before agreements are signed, there will be increased transparency and communication about when capital expenditure will be required, including the circumstances under which the franchisee is likely to recoup the expenditure.

Franchisors and franchisees will be obligated to discuss significant capital expenditure requirements prior to entering an agreement. The franchisor must include as much information as practicable about the expenditure in the disclosure document, including:

- the rationale for the expenditure;
- the amount, timing and nature of the expenditure;
- the anticipated outcomes and benefits of the expenditure;
- the expected risks associated with the expenditure.

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Franchisors will not be able to impose significant capital expenditure just because they unilaterally consider there to be a business case. However, franchisors will still be able to require expenditure when:

- it is disclosed to the franchisee before they enter the agreement
- is legally required
- it applies to all franchisees and has been approved by a majority of them or
- if it applies to a minority of franchisees, has been agreed to by the franchisee.

Stakeholder views

There was no clear agreement amongst stakeholders although many agreed that capital expenditure associated with leasing arrangements in shopping centres complicated the issue. Some stakeholders suggested that capital expenditure should be commensurate with the timeframe of the franchising agreement so that costs could be recuperated by the franchisee.

Require disclosure of end-of-term arrangements for franchisee goodwill

Under this option, the Government would require franchisors to disclose end-of-term arrangements for franchisee goodwill (if any) in the disclosure document.

Stakeholder views

Stakeholders have indicated this measure would help align franchisees' and franchisors' expectations at disclosure, and assist franchisees in making a more informed decision before entering into the franchise agreement. Stakeholders have further indicated this could help minimise disputes at the end of, or at a later point, in the agreement.

Require master franchisors to meet requirements of marketing funds

Under this option the Government would amend clause 12 of the Franchising Code of Conduct to provide that a master franchisor must comply with clauses 15 and 31 where the sub-franchisee is directly or indirectly required to contribute to a marketing or cooperative fund controlled or administered by the master franchisor.

Stakeholder views

Franchisees and the FCA are generally supportive of this change.

Franchisors would be required to include a statement about the accuracy of financial statements

Under this option the franchisor would be required to make a statement confirming that, 'to the best of the franchisor's knowledge', financial statements provided in the disclosure document are 'accurate, correct and compliant' with the Franchising Code and accounting standards.

Some stakeholders have suggested that this statement is not required, as franchisors are already banned from making false or misleading representations by the ACL. Others suggested it would remind franchisors of their obligations and promote confidence in disclosure amongst prospective franchisees.

Franchisors have indicated that they may not have access to the financial information of their franchisees. Several franchisors raised concerns that they feel they open themselves to liability if they provide franchisees with financial information that may be misleading, even if it is done so inadvertently.

Stakeholder views

Franchisors were concerned about a requirement to actively verify financial information

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provided by an exiting franchisee to prospective franchisees unless they are able to state without liability that the information is ‘unverified’.

Many stakeholders, including franchisees, advisers and Small Business Commissioners, were of the view that the provision of accurate financial information at disclosure was important. Accurate financial information is needed for franchisees to make an informed business decision about the franchise.

Additional requirements where the franchisor is terminating in special circumstances

Under this option the Government would amend the Franchising Code to require the franchisor to provide the franchisee with seven days’ notice of a proposed termination in special circumstances (clause 29), so that a mediator or arbitrator can assist the parties to negotiate.

Stakeholder views

Submissions to the consultation paper process showed that a number of stakeholders, including the FCA, thought it important that franchisors maintain the ability to terminate an agreement where there was the possibility of reputational risk, fraud or a health and safety risk.

Franchisees have stated that there should be some ability to challenge termination through the Code, and to ensure that special termination rights are not used opportunistically. For example, the Caltex National Franchise Council submitted to the PJC that many franchisees experienced the termination of their Franchise Agreements for what they considered were non-material breaches or alternatively minor breaches capable of remediation.

5.2.2 What are the costs and benefits of this option?

Quantitative costs

See Appendix A for the assumptions made in order to complete the costings below.

See Appendix B for the full costings of this option.

Regulatory Burden estimate

	Business costs	Community costs	Individual costs	Total costs
Total Costs	\$ 3.92M	\$ n/a	\$ n/a	\$ 3.92M

The regulatory burden estimate (RBE) is calculated as the average annual equivalent cost over the first 10 years of the policy. For a breakdown of this estimate see Appendix B

Qualitative costs and benefits

Public Franchisor Register

The costs and benefits of a public franchisor register is currently not quantifiable due to the need to consult on the final design of the register. An impact analysis of the register will be conducted separately following consultation with the sector. Depending on the design, some possible costs and benefits are identified under ‘stakeholder views’ in the discussion above relating to the register. These will be explored further through consultation.

Key Disclosure Information Fact Sheet

The Fact Sheet would benefit franchisees by providing them with a simple summary of financial and other critical information that is important for making an initial assessment about the franchise offer. Although it is not intended to be a substitute for the full disclosure document, it will help franchisees, and their professional advisers, prioritize the consideration of critical information.

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A summary disclosure document will impose only a minor compliance burden on franchisors because it will be a summary of information already prepared, at least annually, for the disclosure document update. Franchisors would also benefit from franchisees being better informed at the point of disclosure, as this will likely reduce disputation caused by misunderstandings between the n

It is expected that the introduction of the Fact Sheet will provide the sector with a net benefit to the sector over all.

Changes in disclosure practices

Better disclosure practices will benefit both franchisees and franchisors – as discussed above in relation to the Key Disclosure Information Fact Sheet, franchisees being better informed at the point of disclosure will likely reduce disputation caused by misunderstandings between the franchisor and franchisee during the agreement term.

There is a small possibility that overly burdensome disclosure requirements could deter businesses from utilizing the franchising business model, or deterring international franchises from entering the Australian market. On the other hand, a well-regulated sector with a high standard of pre-entry due diligence may be beneficial for attracting international investment.

The regulatory costs associated with improved disclosure are outweighed by the benefits associated with better informed prospective franchisees.

Cooling off measures

Under existing provisions in the Franchising Code, the franchisor can recoup costs associated with a franchisee exercising their right to cool-off. This will have the effect of negating the costs associated with an extended cooling off period for franchisees.

As was discussed in the problem section above, franchisees can be affected by ‘optimism bias’, where they are reluctant to face the downside of an investment to which they have become emotionally attached. The proposed cooling off measures will be beneficial to franchisees who have been motivated to sign on due to an initial emotional impetus – these measures are a chance for poorly informed or overly optimistic franchisees to get out when ‘reality hits’.

Additional benefits to franchisees of these measures would include the ability to examine important documents (including the terms of the lease in certain circumstances) over an additional seven days before being locked into the franchise agreement. Proper due diligence, especially on financial disclosure, is needed in order for the franchisee to make an optimal business decision.

Further, these measures would extend cooling off provisions to the transfer of agreements. This will ensure that all prospective franchisees will have the opportunity to contemplate their decision more thoroughly, not just those signing on to a new franchise agreement.

Given the above, the benefits are expected to outweigh the costs of this measure.

Amending the relevant clauses of the Franchising Code to apply recent automotive franchising changes relating to capital expenditure

While this measure will impose a regulatory burden on franchisors (see discussion in Appendix B), the cost to franchisors would be outweighed by the benefit to franchisees from the increased transparency and the protections against capital expenditure requirements that they are not able to recoup. Benefits include reduction in disputes and improved financial security for franchisees. The qualitative costs and benefits outlined in *changes in disclosure practices* above would also apply to this measure.

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Requiring master franchisors to meet requirements of marketing funds

Improved understanding will likely arise from making the requirements under clauses 15 and 31, relating to disclosure on marketing and other cooperative funds consistent, and ensuring disclosure provisions apply to master franchisors. There is likely to be minimal regulatory burden on franchisors arising from these proposals. Indeed, they may reduce the burden of compliance with the current inconsistent provisions.

The qualitative costs and benefits outlined in *changes in disclosure practices* above would also apply to this measure.

Additional requirements where the franchisor is terminating in special circumstances

Currently, franchisors are able to terminate in special circumstances (as defined by the Franchising Code) without notice to the franchisee if the franchise agreement provides for them to do so.

Amending the Franchising Code to require the franchisor to provide the franchisee with seven days' notice of the proposed termination, so that a mediator or arbitrator can assist the parties to negotiate in the context of termination of the franchise agreement, will benefit franchisees by ensuring that franchisees have an opportunity to challenge the termination, or initiate dispute resolution.

In circumstances where immediate termination is warranted, this delay may be costly to the franchisor or even the public – for example, if a franchisee business has somehow endangered public health and safety, further people could be at risk, as well as the reputation of the whole franchise brand. However, it is expected that if conduct of a franchisee has been severe enough to warrant immediate termination, there will be mechanisms to ensure swift termination where necessary.

While this measure will impose a slight regulatory burden on franchisors, it will decrease the franchisor's ability to quickly stem the effects of the likely serious nature of the circumstances in which the franchisee is to be terminated. For example, if a franchisee's business has somehow endangered public health and safety, the wider community could be at risk, as well as the possibility of reputational damage to the franchise brand.

However, it is important terminations arising from breaches are justifiable. This measure will protect the rights of franchisees to have recourse to alternative dispute resolution processes.

5.3 Option 3: Non-regulatory reforms to the franchising sector

5.3.1 What does this option involve?

Under this option, the Government would take non-regulatory action to address problems identified such as initiatives to improve the education levels of franchisees prior to entering into franchising, and other measures which do not have an associated compliance burden.

Improving prospective franchisees' understanding of the importance of due diligence and other key information regarding operating a franchise would assist in avoiding many of the problems identified by PJC and Franchising Taskforce consultation process.

Reforms to better inform franchisees and improve transparency

A new government online educational resource for the franchising sector

The Government would develop a website, consistent with Recommendation 18.2 of the PJC's *Fairness in Franchising* report. The proposed website would contain a range of information relevant to all stages of the franchise relationship such as information on due diligence when entering into a franchise agreement to information on options to exit the franchise system. Further consultation

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will be conducted to ensure the design of the website promotes the objectives of better informed franchisees

Stakeholder views

Submissions to the Franchising Taskforce's Issues Paper showed that most stakeholders considered that a franchising website would be helpful.

Amend Information Statement with existing franchisee obligations

Under this option, the Government would amend the Information Statement to advise prospective franchisees that their obligations include obtaining information about employment matters and compliance with relevant laws.

Stakeholder views

Franchisees and FCA were generally supportive of this measure.

Raise awareness of the use of 'no agent' and 'entire agreement' clauses

Under this option, the Government would amend the Information Statement to address the use of 'no agent' and 'entire agreement' clauses, and ask the ACCC to refer to these terms in its educational material.

Stakeholder views

The FCA supported these measures, but notes that it is not clear whether 'no agent' and 'entire agreement' clauses protect franchisors. The FCA argues mandating legal and business advice will have a far greater impact.

The ACCC was supportive of include a warning about these terms as part of its general educational material.

Clarification of cooling off period

Clarification would be provided in the Franchising Code that the cooling off and disclosure periods are measured in calendar days and that the 14 day disclosure period must begin at least 14 days before the signing of a franchise agreement.

Stakeholder views

Submissions to the consultation paper process showed that there was general support for the clarification of franchise cooling off periods.

Improve consistency within the Franchising Code about the treatment of marketing funds, particularly clauses 15 and 31

The Franchising Code would be changed to clarify obligations with respect to marketing funds. This may include clarifying what would be 'meaningful information' for the purposes of clause 15 of the Franchising Code. This could assist parties in understanding their obligations.

Stakeholder views

Franchisees and the FCA were generally supportive of this option.

Education on best practice financial statements for marketing funds

Under this option, the Government would work with the sector to emphasise the importance of developing best practice financial statements for marketing funds, and additional efforts would be made to educate the franchising sector on the preparation of financial statements.

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Stakeholder views

Stakeholders have suggested that improved interpretation of the existing provisions may reduce the incidence of disputes over the use of marketing funds.

Education on distribution of unused marketing funds

Under this option, the Government would amend the Information Statement and use educational materials to improve franchisees' understanding that, if the franchisor becomes insolvent, they may lose the benefit of shared funds such as marketing funds.

Stakeholder views

Some stakeholders advocated for the Code to expressly clarify the distribution of unused marketing funds in the event of the franchisor going into liquidation. Other stakeholders argued that should the costs and risks of administration become too onerous, franchisors may choose not to operate shared marketing funds and instead recoup marketing costs through other means (such as franchise system fees).

Improve awareness of wastage and shrinkage payments

Under this option, the Government would improve awareness of the issue of wastage and shrinkage payments by franchisees. The government will draw on existing channels designed for education and guidance, in addition to the proposed website.

Stakeholder views

There was no significant feedback on the issue of wastage and shrinkage.

Measures to address poor conduct and improve compliance and enforcement

Introduce civil pecuniary penalties for a breach of clause 31

Creating a civil pecuniary penalty for marketing fund provisions in clause 31 will deter breaches of the Franchising Code. Penalties for non-compliance may boost confidence in the operation of marketing funds.

Stakeholder views

Franchisees and the FCA were generally supportive of this measure.

Double the civil pecuniary penalties for breaches of the code

Under this option the Government would double the civil pecuniary penalty for breaches of the Franchising Code from 300 penalty units to 600 penalty units.

There is compelling evidence that existing penalties do not deter poor conduct. This is a significant increase in penalties and will further deter parties from breaching the Franchising Code. The power to seek financial penalties is a fundamental part of the ACCC's enforcement toolkit.

Stakeholder views

Submissions to the consultation paper process showed that many stakeholders supported increasing penalties to deter non-compliance and prevent misrepresentations and abuse of the franchising relationship. FCA thought any increase should be accompanied by greater clarity for franchisors about what was expected of them.

Prohibition of franchisors passing on the legal costs to the franchisee

Under this option, the Government would prohibit (and have pecuniary penalties for) franchisors passing on the legal costs of preparing, negotiating and executing documents to the franchisee (except where it is already incorporated into a joining fee).

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Stakeholder views

The FCA made the point that franchisors would probably raise entry fees if a prohibition is introduced, though it would support a prohibition on charging above the standard fixed fee for costs of negotiations.

The AAF did not comment on this recommendation.

Government to develop best practice models for unilateral variations

Under this option, the Government would work with stakeholders to develop best practice models in relation to the process by which a franchisor makes unilateral variations to contracts and subsidiary documents.

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

Stakeholder views

Stakeholders, including the FCA and franchisors considered that there are good reasons for making unilateral decisions, including for health and safety requirements, to implement new legislation, to innovate or grow the business and maintain market relevance. Franchisees on the other hand felt that franchisors were insulated from the risk of business failure and that they were forced by franchisors at times to opt into deals they did not want.

Improvements to exit and dispute resolution

Incorporate the functions of the Franchising Mediation Adviser into ASBFEO

The FMA role under the Franchising Code would be incorporated into the functions of ASBFEO. This would formalise existing administrative arrangements.

Stakeholder views

Many stakeholders such as 7-Eleven convenience store had no objection to OFMA merging with ASBFEO. Submissions to the consultation paper process showed that stakeholders are generally happy with the mediation process and thought ASBFEO was doing a good job and was well-placed to deliver the mediation adviser services. The rationalisation of OFMA and ASBFEO was broadly supported by franchisors and franchisees, including peak industry associations like FCA, and by ASBFEO.

Introduce conciliation and voluntary arbitration

Under this option, the Government would introduce conciliation to complement existing dispute resolution provisions and implement a voluntary arbitration model by appointing a Franchising Arbitration Adviser, utilising a model similar to that in the Dairy Code of Conduct.

Stakeholder views

Access to justice, including costs and timeliness, was raised by a number of stakeholders in submissions to the consultation paper. Some franchisees considered that mediation outcomes were limited by the power imbalance between the parties entering into mediation. Others considered a fear of retribution meant mediation was underutilised. Advisers thought many disputes were brought to mediation too late to save the relationship between the parties. There was support for a three-stage approach to dispute resolution: mediation, conciliation and arbitration.

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Clarify the availability of multi-party mediation

Under this option, the Government would amend the Franchising Code to clarify that, if the person conducting the dispute resolution process determines it is appropriate to conduct a multi-party process, the franchisor cannot refuse to take part in that process.

If implemented, the Government would increase awareness of these measures to ensure the franchising sector is informed of their obligations and rights in relation to multi-party mediation.

Stakeholder views

The Government has heard from the Office of the ASBFEO that under the current Code, franchisors are able to refuse multi-party mediation, and this can lead to franchisees being 'picked-off' by the franchisor through separate mediation processes. ASBFEO has stated that multi-party mediation is not common, despite that it is a process that works well.

Furthermore, many stakeholders indicated that they were unaware of their ability to engage in multi-party mediation.

Submissions to the consultation paper process showed that there was considerable support for clarifying multi-party dispute resolution.

Develop amendments to the Franchising Code to facilitate negotiated early exit

Under this option, the Government would consult with the franchising sector to develop amendments to the Franchising Code to facilitate negotiated early exit that balances the rights and interests of franchisors and franchisees.

Stakeholder views

Some stakeholders, primarily franchisors and professional advisors, claim that introducing franchisee termination rights may affect the franchisor's ability to make long-term investment decisions due to the reduced certainty of the contract, and may also lead to a higher turnover in franchise systems.

Furthermore, some stakeholders claim that not all franchisees exit their franchise in good faith, arguing that franchisees should not be permitted an easy exit from their contract for reasons outside the franchisor's control, such as unfavourable economic conditions.

Submissions to the consultation paper process showed that there was no clear agreement amongst stakeholders on this measure. A number were happy with the current provisions of the Code but thought the terms of the agreement should outline the exit arrangements so the parties are clear about them at the outset. Academics, lawyers and other advisors noted the current existence of legal options to deal with 'unreasonable impositions', such as unconscionable conduct and UCT laws.

Some franchisees considered that franchisors should be obliged to specify their deliverables and only change them with the agreement of the franchisee. If franchisees are not able to meet their deliverables, franchisees should be able to exit the agreement.

Clarify and educate regarding restraint of trade clauses in franchising

Under this option, the Government would increase prospective franchisees' awareness of the effect of restraint of trade clauses, clarify what constitutes a breach of clause 23 of the Franchising Code, and amend the Information Statement to warn prospective franchisees of the need to obtain legal advice on restraint of trade before entering the agreement.

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Stakeholder views

Submissions to the consultation paper process showed that stakeholders did not agree on the operation of restraint of trade clauses. Some franchisors noted that dilution of restraint of trade clauses could lead to hardship to small franchisor business. Others supported greater awareness raising amongst franchisees of restraint of trade provisions within franchise agreements.

5.3.2 What are the costs and benefits of this option?

Quantitative benefits

See Appendix A for the assumptions made in order to complete the cost offsets below.

See Appendix C for the full costings of this option.

Note that the cost offsets in the table below are only associated with the multi-party mediation component of this option.

Cost offset estimate

	Business cost offsets	Community cost offsets	Individual cost offsets	Total cost offsets
Total cost offset	\$ 3.12M	\$ n/a	\$ n/a	\$ 3.12M

The cost offset estimate is calculated as the average annual equivalent cost offset over the first 10 years of the policy. For a breakdown of this estimate see Appendix C.

Qualitative costs and benefits

Education and awareness measures²²

Education and awareness will benefit both franchisees and franchisors. The proposed measures will assist prospective franchisees with conducting proper due-diligence prior to entering a franchise agreement by simplifying and streamlining the process, and filling information gaps that were identified by the PJC.

The online resource would be a central point where prospective franchisees, and industry stakeholders in general, would be able to access crucial, reliable and current information. Although the final design of the website is pending consultation, it would likely bring existing information produced by the ACCC, ASBFEO, the Fair Work Ombudsman (FWO), business.gov.au, and the Australian Taxation Office (ATO) together, in addition to further guidance material. It would act as a comprehensive online resource for the franchising sector, and save on search costs and create efficiencies in the process of information gathering for franchisees.

Franchisees who have conducted proper due-diligence would be in a better position 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 could also reduce the risk of falling into a dispute with the franchisor due to unforeseen issues arising from a lack of understanding of the franchise agreement, thus reducing the number of incidences of parties entering into dispute resolution.

²² This discussion considers costs and benefits associated with developing an online educational resource for the franchising sector; amending the Information Statement to emphasise the importance of prospective franchisees understanding Franchising Code requirements and to warn prospective franchisees of the need to obtain advice about restraints of trade before entering the agreement; raising awareness of the use of 'no agent' and 'entire agreement' clauses; providing education on best practice financial statements; providing education on distribution of unused marketing funds; improving awareness of wastage and shrinkage payments.

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There will be no cost to industry. As such, the aforementioned measures will result in a net benefit to the sector as a whole.

Improvements to access to justice in the franchising sector

This section considers costs and benefits associated with incorporating the functions of the Franchising Mediation Advisor (FMA) into ASBFEO, and introducing conciliation and voluntary arbitration to the franchising dispute resolution process.

Incorporating the FMA role into ASBFEO would make it clearer to franchisees and franchisors where they should seek assistance from. This is also consistent with the broader dispute resolution assistance that ASBFEO provides to small business.

Arbitration is generally more expensive than mediation, however it can deliver a binding outcome. It is likely to be cheaper and more flexible than pursuing court action. Conciliation is a variation on mediation which gives the party facilitating dispute resolution more flexibility to assist the parties to reach an outcome where needed.

The combination of these two measures would simplify the franchising dispute resolution process and provide multiple avenues for industry parties to accessible, affordable and effective dispute resolution. Exact costs and benefits cannot be estimated as this would depend on the number of instances of dispute and the nature of the disputes themselves, however these reforms would have a beneficial impact on the sector as a whole.

Best practice models and amendments to facilitate negotiated early exit

Under this option, there are a number of measures that the Government would need to consult on with the sector to ensure changes to the Franchising Code are fit for purpose.

Working with the sector on the design of reforms would involve costs for both Government and sector participants, which includes time taken to organize and respond to consultation.

However, involving end-users in the reform process is important – it ensures that the utility of the Code is maximised for sector participants and reduces unintended consequences. The industry codes framework administered by the Department of the Treasury confirms the importance of public consultation as an element of the policy making process, particularly in determining whether a code can provide the right regulatory support without imposing unnecessary red tape on businesses.

Exact costs and benefits of the specific changes cannot be estimated at this time as they are subject to the final design of the measures, which would be settled through consultation.

Extending and increasing penalties

The maximum penalty for a breach of the Code is set by the CCA. Under this option, the Government would amend the CCA to increase the maximum civil pecuniary penalty available for a breach of an industry code from 300 to 600 penalty units, and increase the civil pecuniary penalties for breaches of the Franchising Code accordingly. The Government would also extend penalties to a breach of clause 31 of the Franchising Code which relate to the management of marketing and advertising fees.

The PJC found franchisors do not face sufficient deterrents for non-compliance with the Franchising Code. Penalties are an important part of the ACCC's enforcement toolkit and raising penalties would benefit the franchising sector by deterring breaches of the Franchising Code, lifting standards of behaviour in the sector and restoring confidence in the franchise business model. There would be no additional cost to franchisors who do not breach the Code.

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Doubling penalties available under the Code may impose significant costs for small franchisors who breach the Code and do not have the financial means to pay for it. This would have further ramifications for the affected franchisor's franchisees who would be at risk if the franchisor were to wind-up its operations as a result of the imposed penalty. However, the prescribed penalties would be a maximum and a court could impose a lesser amount if in the judgment of the court that is warranted.

The doubling of financial penalties available under the Franchising Code, coupled with existing protections provided by the CCA and ACL, would improve deterrence, enhance compliance and increase standards of franchisor behaviour. This would provide a net benefit to the sector as a whole.

5.4 Option 4: Reform and refine the franchising sector with regulatory and non-regulatory measures (preferred)

5.4.1 What does this option involve?

Under this option, Options 2 and 3 would be implemented as a comprehensive franchising reform package.

5.4.2 What are the costs and benefits of this option?

Quantitative costs and benefits

See Appendix A for the assumptions made in order to complete the costings below.

See Appendix B and C for the full cost benefit analysis of this option.

Regulatory Burden and Cost Offset (RBCO) Estimate Table

	Business costs/offsets	Community costs/offsets	Individual costs/offsets	Total costs/offsets
Total costs	\$ 3.92M	\$ n/a	\$ n/a	\$ 3.92M
Total cost offsets	\$ 3.12M	\$ n/a	\$ n/a	\$ 3.12M
Net regulatory cost	\$ 800,000	\$ n/a	\$ n/a	\$ 800,000

The RBCO is calculated as the average annual equivalent cost/cost offset over the first 10 years of the policy. For a breakdown of this estimate see Appendix B and C.

Qualitative costs and benefits

This option will have the qualitative costs and benefits of options 2 and 3. See above.

6. Consultation

Extensive consultation across the breadth of the franchising industry has identified a range of views about the degree and direction of regulatory reform needed to address issues in the sector. Additional consultation by the Taskforce has reaffirmed the issues identified by the PJC and further built the evidence base for government intervention.

6.1 Franchising Taskforce

The Franchising Taskforce consulted with relevant stakeholders to ensure that multiple perspectives were considered. A number of consultation channels were established in order to inform the options put forward in this Regulation Impact Statement (RIS), including an Issues paper, a consultation paper and stakeholder meetings and roundtables.

➤ Issues paper

The Franchising Taskforce released an Issues Paper on 23 August 2019 to inform the consultation paper options and its advice to Ministers. The Issues Paper invited feedback to the Franchising Taskforce on the PJC's recommendations. The Issues Paper grouped the 71 PJC recommendations report under seven draft policy principles. These seven principles followed the life cycle of a franchise business from a prospective franchisee considering a franchise agreement to their exiting the agreement, with one principle discussing the regulatory framework across all phases. In recognition of the large proportion of culturally and linguistically diverse franchising stakeholders, the Issues Paper was translated into simplified Chinese, Arabic and Korean.

Submissions to the Issues Paper could be made via a number of channels including email, phone, and through an online Issues Paper consultation form which allowed for anonymous responses.

Responses to the Issues Paper were received from 75 stakeholders.

➤ Consultation paper

Submissions to the Taskforce's Issues Paper informed the development of a consultation paper. The Taskforce's consultation paper was released on 11 November 2019 and sought feedback on possible problems and options for government action in the franchising sector.

Responses to the consultation paper were received from 73 stakeholders.

➤ Stakeholder meetings and roundtables

The Franchising Taskforce and its support officers conducted 74 separate meetings prior to the Taskforce being established. These meetings were with a range of stakeholders from across the franchising sector and in government, including franchisees, franchisors, professional advisors, peak bodies and other government agencies. These meetings were held both face-to-face and via teleconference.

The Franchising Taskforce held two roundtables in Canberra in September 2019, one for franchisees and the other for franchisors.

6.2 Future consultation

It is anticipated that industry to be involved in the final design of key reforms, in order to minimise the likelihood of unintended consequences and build the sector's awareness on the intent and purpose of the proposed measures.

7. Conclusion and recommended option

This thorough review and consultation process resulted in the Franchising Taskforce advising the Government on improvements to the Franchising Code, and relevant provisions of the CCA. These suggestions have been tested against their respective costs and benefits throughout a comprehensive consultation process.

The package of changes put forward in Option 4 of Chapter 5, responds to problems in a manner that ensures the costs of taking action are outweighed by the benefits. The proposal presents an opportunity to ensure the Franchising Code remains fit for purpose, and addresses the problems identified by the PJC while limiting red tape and complexity for the sector.

It is recommended that the Government reform and refine franchising regulation in accordance with Option 4 in Chapter 5.

To summarise, if Option 4 is accepted, the Government would take the following actions to address the identified problems in section 3.

The Government would:

- Increase the information available to prospective franchisees before they enter the franchise agreement
- Improve prospective franchisees' access to financial and non-financial information, including supply arrangements, rebates and marketing and other cooperative funds, supporting their ability to conduct due diligence
- Educate franchisees on the use of 'no agent' and 'entire agreement' clauses, the issues of wastage and shrinkage payments and rights in relation to cooling off and disclosure periods through the Information Statement, ACCC educational material, the franchising website and other avenues
- Strengthen franchisees' rights in relation to significant capital expenditure
- Enhance the management of the dispute resolution services and organisations, including providing for multi-party dispute resolution under the Franchising Code, conciliation and arbitration
- Balance the rights of franchisors and franchisees to facilitate and negotiate an early exit from a franchise agreement, including by increasing disclosure on of end-of-term arrangements for goodwill and improving awareness of restraint of trade clauses
- Establish a more effective enforcement regime to encourage greater compliance with the Franchising Code by doubling pecuniary penalties for a breach, monitoring the effectiveness of regulatory reforms, collaborating across all relevant agencies and with the franchising sector
- Work with stakeholders to develop best practice models in relation to unilateral variation of contracts
- Prohibit franchisors passing on the legal costs of preparing, negotiating and executing documents to the franchisee (except where it is already incorporated into a joining fee)

These proposals are a balanced reform package that maintains the basic regulatory framework of the Franchising Code while introducing new measures to strengthen the industry and protect franchisees.

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While the Government recognises that some preferred options will impose a regulatory burden across all franchisors, including compliant businesses, the reforms as a whole will result in an overall net benefit to the franchising industry and the Australian economy and society.

Other measures, such as doubling the maximum civil pecuniary penalties for breaches of the Franchising Code that carry a penalty and the introduction of conciliation and arbitration, will encourage greater compliance and deter misconduct in the sector, but have little or no regulatory impact.

8. Implementation and evaluation

8.1 Implementation and transition

Implementation of the recommended reform would require careful planning to keep transition costs low and ensure that compliance remains high.

The proposed form of legislative changes to the Franchising Code would be exposed for a period of public comment ('exposure draft'). This will be intended primarily to capture any unintended consequences arising from implementation and provide the sector with an opportunity to comment in a way that ensures that policy objectives of government are met.

Legislative reform will then follow the usual government process. Consideration will be given to the appropriateness of staging reform.

Following passage of legislative reform and finalisation of non-regulatory measures, awareness-raising activities and guidance material will be developed to assist businesses to understand and comply with the new requirements.

The ACCC would then maintain its educative work and be prepared to undertake enforcement where appropriate to ensure compliance with the Franchising Code.

8.2 Evaluation

The Franchising Code is prescribed by regulation. The regulation is a sunset instrument, meaning it will be examined in accordance with the review provisions of the *Legislation Act 2003* (Cth).

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Appendix A

General assumptions and parameters

In quantifying the costs and savings associated with changes to the Franchising Code, the following general assumptions have been applied:

- The cost of legal advice is \$500 per hour.²³
- The average cost of an owner-manager's time is \$39 per hour.²⁴
- The average cost of an employee's time is \$32 per hour.²⁵
- The average cost of a manager's time is \$64 per hour.²⁶
- Changes to the Franchising Code will only apply prospectively.
- There are approximately 1,240 franchisors operating under the Franchising Code.
- There are approximately 95,600 franchisees operating under the Franchising Code.
- For 2009 – 2019, there was an average of 2,236 new franchisees per year.
- Franchisor takes on an average of 1.8 new franchisees per year.²⁷
- 32 per cent of systems in Australia use a master/foreign franchisor structure. This equates to 397 franchisors.²⁸

Costings have been prepared as the average annual equivalent over a 10 year period from when the changes take effect.

²³ This figure is based on DISER's RIS *Franchise relationships between car manufacturers and new car dealer*, released February 2020.

²⁴ According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2018), the average weekly cash earnings of an owner manager of an incorporated enterprise is \$1,486. Based on owners working a 38 hour week, this equates to approximately \$39 per hour. This publication was released 22 January 2019 and is available from the [Australian Bureau of Statistics website](#).

²⁵ According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2018), the average weekly cash earnings of a non-managerial employee is \$ 1,227.30. Based on employees working a 38 hour week, this equates to approximately \$32 per hour. This publication was released 22 January 2019 and is available from the [Australian Bureau of Statistics website](#).

²⁶ According to the Australian Bureau of Statistics Publication 6306.0 *Employee Earning and Hours Australia* (May 2018), the average weekly cash earnings of a managerial employee is \$2,424.50. Based on employees working a 38 hour week, this equates to approximately \$64 per hour. This publication was released 22 January 2019 and is available from the [Australian Bureau of Statistics website](#).

²⁷ Updated using data from IBISWorld September 2019 report and IBISWorld July 2020 report, based on calculations made in the 2014 franchising RIS which stated that For 2002 – 2012, there was an average of 1,890 new franchisees per year. Each franchisor takes on an average of 1.6 new franchisees per year.

²⁸ Research by Griffith University, presented in the Franchising Australia 2012 report (page 85). An electronic copy of the report is available from the [Griffith University website](#).

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Appendix B

Qualitative costs

Regulatory burden estimate table

Average annual regulatory costs (from business as usual)				
Government action	Business	Community	Individual	Total
Reforms to better inform franchisees and improve transparency				
A public register of franchisors	See qualitative costs in section 5.2.2			
A Key Disclosure Information Fact Sheet containing information that is taken from disclosure documents	\$ 96,720 ²⁹	\$ n/a	\$ n/a	\$96,720
Electronic and hard copy disclosure documents	See total costs associated with a minor change in practice			
Separate information statement				
Provision of the ACCC's Franchisee Manual to prospective franchisees				
Financial disclosure in disclosure document				
Increased transparency around retail leasing	See total costs associated with updating the disclosure document			
Improved disclosure around supplier rebates				
Extend cooling off and				

²⁹ 2 hours of the franchisors time annually (the fact sheet will be updated once a year, in line with the obligation to update franchise disclosure documents annually) x \$39 per hour x 1,240 franchisors x 10 years = \$967,200. This equates to an average annual regulatory cost of \$96,720. Note this figure is subject to change following stakeholder consultation on the final form of the Key Disclosure Information Fact Sheet, which will decide the final design of the Fact Sheet and therefore the time taken by franchisors to develop this documentation.

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parameters to trigger start of cooling off period	See qualitative costs in section 5.2.2			
Cooling off rights extended to transfers				
Amend the relevant clauses of the Franchising Code to apply recent automotive franchising changes relating to capital expenditure	\$1,605,520 ³⁰	\$ n/a	\$ n/a	\$1,605,520
Require disclosure of end-of-term arrangements for franchisee goodwill	See total costs associated with updating the disclosure document			
Require master franchisors to meet requirements of marketing funds	\$18,580 ³¹	\$ n/a	\$ n/a	\$18,580
Franchisors would be required to include a statement about the accuracy of financial statements	See total costs associated with a minor change in practice			
Improvements to exit and dispute resolution				
Additional requirements where the franchisor is terminating in special circumstances	See qualitative costs in section 5.2.2			
Other				

³⁰ See full business costs of this measure below.

³¹Note that approximately 60 per cent of franchise systems have a marketing fund. Thus the burden will be 2 hours annually x \$39 per hour x (60% x 397 master franchisors) x 10 years = \$185,796. This equates to an average annual regulatory cost of \$18,580.

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Total costs associated with a minor change in practice	\$96,720	\$ n/a	\$ n/a	\$96,720
Total costs for updating the disclosure document (see calculation below)	\$241,800	\$ n/a	\$ n/a	\$241,800
Total transitional costs associated with obtaining legal advice on regulatory changes	\$1,860,000 ³²	\$ n/a	\$ n/a	\$1,860,000
TOTAL	\$ 3.92M ³³	\$ n/a	\$ n/a	\$ 3.92M

The regulatory burden estimate (RBE) is calculated as the average annual equivalent cost over the first 10 years of the policy. For a breakdown of this estimate see Appendix B

Total costs associated with a minor change in practice

It is expected that implementing the following minor changes to franchisor’s business practices:

- Electronic and hard copy disclosure documents
- Separate information statement
- Provision of the ACCC’s Franchisee Manual to prospective franchisees
- Financial disclosure in disclosure document
- Franchisors would be required to include a statement about the accuracy of financial statements.

Will take franchisors 2 additional hours in document preparation time. Franchisors are obliged to update their disclosure documents annually.

Therefore the total RBE over 10 years of these measures will approximately be:

$$2 \text{ hours annually} \times \$39 \text{ per hour} \times 1,240 \text{ franchisors} \times 10 \text{ years} = \$967,200$$

The annual average cost of these measures equates to \$96,720

Total costs associated with updating the disclosure document

It is expected that updating the disclosure document in order to provide:

- Increased transparency around retail leasing
- Improved disclosure around supplier rebates;
- Amend disclosure requirements to ensure end-of-term arrangements for franchisee goodwill
- Additional requirements where the franchisor is terminating in special circumstances

³² See discussion on transitional legal costs below.

³³ Approximately \$3,919,340

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Will take a franchisor approximately 5 hours. Franchisors are obliged to update their disclosure documents annually.

Therefore the total RBE over 10 years of these measures will approximately be:

$$5 \text{ hours annually} \times \$39 \text{ per hour} \times 1,240 \text{ franchisors} \times 10 \text{ years} = \$2,418,000.$$

The annual average cost of these measures equates to \$241,800.

Amend the relevant clauses of the Franchising Code to apply recent automotive franchising changes

The Government introduced significant reforms to automotive franchising regulations which commenced on 1 June 2020. Under the reforms, all new dealership agreements have to take into account additional considerations regarding end of term arrangements, capital expenditure and multi-party dispute resolution. The costings below are in line with costings undertaken in the 2020 *Franchise relationships between car manufacturers and new car dealers* RIS.

This costing assumes that:

- the average term of franchise agreements in Australia is five years, with an option usually available for a similar term on renewal³⁴;
- it would take a lawyer two hours to draft the capital expenditure disclosure part of an agreement which would be updated upon renewal (twice over 10 year period) at a cost of \$500 per hour. It is assumed that franchisors would have a standard form contract and that capital expenditure requirements across systems would be consistent in order to maintain brand consistency within the franchise; and
- the franchisee would attend a one hour meeting with a representative of the franchisor to discuss the capital expenditure requirements (which would occur twice over a 10 year period).

Therefore the total RBE for this measure over 10 years would approximately be:

$$[(\$500 \times 2) \times 2 \times 1,240] + [(\$39 + \$32) \times 2 \times 95,600] = \$16,055,200$$

The annual average cost of these measures equates to \$1,605,520

Total transitional costs associated with obtaining legal advice on regulatory changes

There will be transitional costs associated with franchisors obtaining legal advice on changes to the Code that are introduced through these reforms. It is expected that it would take a lawyer 3 hours to review and advise on the additional regulatory requirements discussed in this appendix and section 5.2.2.

Therefore the total RBE for this one-time transitional costs would be:

$$(\$500 \times 3) \times 1,240 = \$1,860,000.$$

³⁴ FranchiseED, 2018, *Managing Franchise Agreements: Transfers and Renewals*, accessed online at <https://www.franchise-ed.org.au/franchisor/managing-franchise-agreements-transfers-and-renewals/>

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Appendix C

Average annual cost offset (from business as usual)				
Government action	Business	Community	Individual	Total
Reforms to better inform franchisees and improve transparency				
A new government online educational resource for the franchising sector	See discussion on education and awareness			
Amend Information Statement with existing franchisee obligations				
Raise awareness of the use of 'no agent' and 'entire agreement' clauses				
Clarification of cooling off period	See discussion on clarifying and improving the Franchising Code			
Improve consistency within the Franchising Code about the treatment of marketing funds, particularly clauses 15 and 31				
Education on distribution of unused marketing funds	See discussion on education and awareness			
Improve awareness of wastage and shrinkage payments				
Education on best practice financial statements for marketing funds				
Measures to address poor conduct and improve compliance and enforcement				
Introduce civil pecuniary penalties for a breach of clause 31	See discussion on costs and benefits of extending and increasing penalties			
Double the civil pecuniary penalties for breaches of the code				
Prohibition of franchisors passing on the legal costs to the franchisee				
Government to develop best practice models for unilateral variations	See discussion on costs and benefits of Government working with the sector			
Improvements to exit and dispute resolution				
Incorporate FMA into ASBFEO	See discussion on improving access to justice			
Introduce conciliation and voluntary arbitration				
Clarify the availability of multi-party mediation	See discussion on clarifying and improving the Franchising Code			
Develop amendments to the Franchising Code to facilitate negotiated early exit	See discussion on Government working with the sector			
Clarify restraint of trade clause in the Franchising Code	See discussion on clarifying and improving the Franchising Code			

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Amend the Information Statement to warn prospective franchisees of the need to obtain advice about restraints of trade before entering the agreement	See discussion on education and awareness			
TOTAL	\$3.12M	\$ n/a	\$ n/a	\$3.12M

The cost offset estimate is calculated as the average annual equivalent cost offset over the first 10 years of the policy. For a breakdown of this estimate see Appendix C.

Cost offsets developed from clarifying and improving the Franchising Code

The non-regulatory reforms include the following measures which aim to clarify and improve the Franchising Code:

- Clarification of cooling off period
- Improve consistency within the Franchising Code about the treatment of marketing funds, particularly clauses 15 and 31
- Clarify the availability of multi-party mediation
- Clarify restraint of trade clause in the Franchising Code

It is difficult to estimate the savings created by a majority of these measures – it is expected that the clarifications and improvements to the Code will save franchisees and franchisors time and money they may have spent researching or seeking legal advice on these clauses.

However, the clarification of multi-party mediation is expected to produce \$3,123,250 in savings for the sector per year. Analysis of this saving is provided below.

- According to the Franchising Australia 2016 report, disputes with franchisees involving an external advisor were reported by 25 percent of franchisors with a median of two of their franchisees over a 12 month period.
- Typically, commercial lawyers will charge between \$5,000 and \$7,500 for preparation and attendance at a full day mediation.
- Mediation offered through the Office of the Franchise Mediation Adviser is charged at a price of \$300/hr + GST, which is split by the parties involved. The Office of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) estimates that due to the complex nature of many franchise disputes, mediation can span 10 and 20 hours. ASBFEO estimates that on average, mediations cost \$3000 in total (or \$1500 each if split between two parties).
- Assuming 310³⁵ franchisors are in dispute with two franchisees per year, this would equate to an average of \$6250 in legal fees and \$1500 in mediation fees for both the franchisee and franchisor, per dispute.
- This equates to $(310 \times 2 \times \$6250 \times 2) + (310 \times 2 \times \$1500 \times 2) = \$7,750,000 + \$1,860,000 = \$9,610,000$
- However, with multi-party mediation, if the average two franchisees per system per year resolved dispute through one mediation as opposed to two, this would halve costs and save the sector a total of \$4,805,000 per year.
- Although the exact take up rate of multi-party mediation is difficult to calculate, if at least 50 to 80 per cent of mediations in the sector are progressed as multi-party mediations, there

³⁵ 25% of 1,240

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would be a saving of between \$2,402,500 and \$3,844,000 per year to the sector. The average of these two figures is \$3,123,250 per year.

- A saving of \$3,123,250 per year would appear to be a reasonable estimate.
 - A recent automotive franchising dispute involving approximately 185 franchisees provides an example of the type of mediation that would be well suited to multi party mediation.
 - Another example of such a dispute occurred in 2016, where 190 Pizza Hut franchisees took class action against franchisor Yum! for the introduction of a 'value strategy' that was impacting their businesses' viability.
 - If the Franchising Code was amended to explicitly allow multi-party mediation, many more multi-party mediations may occur under the Code.