SUBMISSION TO TRADE PRACTICES ACT REVIEW
BY THE FRANCHISE COUNCIL OF AUSTRALIA LTD.

Background

The last national survey carried out in Australia showed there were 747 franchise systems who collectively had 49,400 franchisees employing 700,000 people. Turnover through the sector was $81 billion. The franchising sector is accordingly a major contributor to the economy.

Franchising represents one of the main techniques, if not the only technique, to enable small business to successfully compete against larger businesses. This issue is important in the context of the apparent intention of the Government to relax merger and competition rules. The Franchise Council of Australia supports the free market principles behind such a decision provided the impact on small business is recognised, and small business is not shackled with a costly and anti-competitive regulatory regime.

By definition, over 98% of the participants in the sector are small businesses. This is a critical point in the context of regulation of the sector by the Australian Competition and Consumer Commission ("the ACCC"). Although the Trade Practices Act ("TPA") has always affected the sector, the introduction of the Franchising Code of Conduct ("the Code") as a mandatory industry code pursuant to the TPA has had the effect of giving the ACCC a much greater role within the sector. The franchising sector is the only sector regulated by the ACCC under the mandatory code regime.

The Franchise Council of Australia Ltd. (FCA) is the peak industry body representing franchisors, franchisees and suppliers/advisors to the sector. This submission has been prepared based on submissions and representations from our members.

Executive Summary

The FCA welcomes the opportunity to make this submission. We enjoy a constructive relationship with the ACCC. We have taken up the matters raised in this submission separately with them, but believe some legislative change and policy direction to the ACCC is necessary to redress the problems we have identified.

The FCA has received numerous complaints from our members concerning the TPA, and the processes and conduct of the ACCC. In terms of the wording of the Terms of Reference, the FCA believes s51AC of the TPA, and the actions and methods of the ACCC:-

- **Inappropriately impede the ability of Australian franchise systems to compete locally** by creating an environment of contractual uncertainty, and indeed in many cases a climate of fear. Few franchise systems could afford the direct and indirect cost of a dispute with the ACCC, and many live in fear of having to defend an unjustified claim based on alleged unconscionable conduct;
- **Unfairly affect the balance of negotiating power** between contracting parties where both parties are small businesses, in that ACCC intervention in effect determines the result rather than facilitates the process;
- **Inhibit the capacity of parties to a franchise agreement to exercise their rights** and obligations with certainty, transparency and accountability. In franchising some of the indicators of unconscionable conduct in s51AC (eg: standard form agreements, inequality of size etc) can be alleged to be present in virtually every case;
- **Do not provide adequate protection** for the commercial affairs of small businesses, particularly when publicity is used by the ACCC as a tactic;
- **Are insufficiently flexible** to take account of the needs of the small business sector.

The FCA has major concerns in relation to section 51AC of the TPA, being the business unconscionability provisions. Our concerns relate to the uncertainty surrounding what constitutes unconscionable conduct, and the process used by the ACCC to purportedly establish legal precedent in the area.

The FCA has previously made submissions concerning the cost of compliance associated with the Franchising Code of Conduct. In this respect we note the terms of reference concerning identification of improvements to the Trade Practices Act. The Code is a regulation under the TPA. It could be substantially improved to reduce costs without affecting the important protections it provides. The FCA would be happy to provide specific suggestions to improve the Code, and seeks a recommendation that Government consult with industry to reduce the cost of compliance associated with franchise sector regulation generally, and the Franchising Code of Conduct specifically.

The outcomes we seek are:-

1. **A clear and fair definition of unconscionable conduct** under S51AC, preferably by legislation or guidelines developed in consultation with industry, so that the boundaries are clear and there is contractual certainty. Alternatively if test case funding is continued, the Government fund both sides of a test case to give either case law or specific guidelines as to S51AC intentions. At present many of the so called test cases are in fact ACCC viewpoints given court endorsement either under the enforceable undertakings process, or (for example in the Simply No Knead case) in the absence of robust contrary argument from the defendant.

2. **The establishment of fair and transparent processes for ACCC conduct in the franchising sector that recognise that small business franchising enforcement issues are different from those that may be appropriate for large businesses**. Enforcement mechanisms must be adjusted, and the ACCC must be mandated to use in the first instance the mediation based dispute resolution processes it championed when the Code was first introduced. The typical ACCC investigative process is unnecessarily costly for all, as it often involves requests for vast amounts of material and information. (In one instance a franchisor's photocopying costs alone had reached many thousands of dollars before any proceedings had even been instituted.);

3. **The independent review and monitoring of the ACCC enforceable undertakings process** to ensure that the ACCC is not using the process to achieve outcomes that would be beyond those that a court would be likely to award in the circumstances;

4. **The banning of the ACCC's trial by the press release / guilt by allegation process**. In franchising publicity affects all members of a network, whether or not they are a party to the alleged dispute. A perusal of the ACCC website will demonstrate that ACCC press releases often appear to serve no purpose other than to promote the ACCC. It will also show that press releases are rarely provided where the ACCC fails to substantiate its allegations, or settle a matter on a basis significantly different from the remedies originally sought. In the context of the self-portrayal of the ACCC as the regulator that never loses a case, some press releases are by content or omission arguably quite misleading.

Reforms to the Trade Practices Act Processes

When the Federal Government introduced its "New Deal - Fair Deal" Reforms in 1998, much was made of the introduction of the Franchising Code of Conduct. However the Franchise Council of Australia pointed out at the time that there were three other significant elements to the changes, each of which was likely to be just as important. This has clearly proven to be the case.

The three matters to which we referred were:-

1. The introduction of the Franchising Code as a regulation pursuant to the *Trade Practices Act,* thereby giving enforcement responsibility to the Australian Competition and Consumer Commission. We predicted a substantially increased focus on the sector by the ACCC, which previously had directed most of its attention to the corporate sector.

2. The introduction of section 51AC, prohibiting "unconscionable conduct" in business transactions. We predicted that this section was more likely to be used by one small business against another than by small business against large business. We criticised the uncertainty associated with the new legislation, notably the fact that there was no precise definition of what constituted unconscionable conduct.

3. The allocation of substantial funds to the ACCC to fund test cases and establish legal precedent in the area of franchising and unconscionable conduct. We commented that this was an inappropriate way to establish precedent, as half of the funding to establish the precedent would in fact need to be found by those involved in the litigation.

Our predictions have proven to be correct. The Franchising Code of Conduct is working well, but the enhanced involvement of the ACCC in the sector and the attempts to establish precedent in the area of unconscionable conduct have contributed to an environment of uncertainty that needs to be redressed.

The original Fair Trading Report recommendations that led to the New Deal – Fair Deal legislation recommended a specific franchise industry regulator. This would be welcomed by the sector, as such a regulator can tailor practices and procedures to suit the sector and help to promote the growth and development of franchising. Nonetheless we remain prepared to accept the ACCC as regulator of the sector, but changes in its processes need to be made. The involvement of the ACCC gives additional credibility to franchising and the regulatory framework. With some policy and process adjustments the role of the ACCC could be even more constructive.

At a policy level the Federal Government has recognised the special position of small business in the context of the proposed exemptions to unfair dismissal legislation. Franchisors are not seeking exemptions, just an enforcement process that recognises that they are small businesses and do not have the compliance resources of major corporations. Similarly the more heavy-handed tactics that the ACCC may argue are necessary where large corporations are involved are totally inappropriate in franchising. Many assets of franchise systems, such as brands and intellectual property, are intangible and can be substantially damaged by publicity or aggressive ACCC behaviour. Franchisees and other third parties not directly involved, but dependent on the intellectual property, can also be substantially damaged.

The policy of using test cases to set legal precedent is fundamentally flawed. It is also contrary to the express policy behind the dispute resolution processes in the Franchising Code of Conduct, which is to encourage mediation of disputes before they escalate. If the Government chooses to escalate a dispute into a test case, which is exactly what this policy does, the Government should in fairness at least fund all parties to the test case. However the better solution would be to define the law more precisely so everyone knows where they stand.

Unfortunately very few franchisors have the financial resources to be able to afford to litigate with the ACCC. Complainants and their legal advisers are beginning to understand this, and we are seeing a substantial amount of resources devoted to convincing the ACCC to take up matters on behalf of complainants. The Franchise Council of Australia is aware of a number of instances where complaints have been made to the ACCC and the ACCC has become involved before any opportunity has been given to the contractual and dispute resolution processes established specifically for the purpose of resolving disputes in the franchising sector. In our view this is most inappropriate. As sponsors of the Code, and indeed primary regulators of the sector, the ACCC should allow the dispute resolution processes as set out in the Code to take their course before becoming involved.

If the ACCC intends to continue to get very actively involved in disputes at an early stage, the ACCC needs to review its investigative processes. They are simply not suited to the small business sector. The procedures may be appropriate when dealing with Trade Practices Act matters where criminal conduct is involved. However few procedural adjustments seem to occur when dealing with purely civil matters. A number of our members have objected to the presumption of guilt that they feel they have encountered when responding to complaints. One reason for this perception may be that the ACCC does not make contact with the franchisor at an early enough stage. It is worth exploring the reasons for this perception.

The consent order process used by the ACCC needs review. The practical reality is that most small businesses will have little choice but to use the consent order process if the ACCC decides to institute proceedings against them. The ACCC must ensure that the ACCC does not seek by consent orders outcomes beyond that which a court would be likely to award. The ACCC must, in seeking consent orders, fairly consider the awards that a court would be likely to make after comprehensive argument from all parties, not just the complainant. The consent order process should be used by the ACCC as a mechanism to achieve an outcome that a court would be likely to award, but in a more efficient consent basis. From information we have received from our members, we have concerns that there may need to be adjustments made.

The ACCC also needs to understand that in franchising the parties involved exploit intangible assets that can be greatly harmed by adverse publicity. The penchant for the ACCC to publicise the issuing of proceedings and the obtaining of consent orders is justified on the basis that it sends a strong message to other participants in the sector. However this policy was developed to assist the ACCC to tackle large corporations, who would frequently frustrate the ACCC by legal action. The same principles should not apply to small business, particularly given the impact of adverse publicity on franchisors and indeed other franchisees within a system. The ACCC needs to develop new processes to deal with small business, which has been a substantial contributor to economic growth over the past 10 years.

We enjoy an excellent working relationship with the ACCC, and we participate in their Consultative Committee and other activities. We join with the ACCC in educational roles,

and we seek to work with them for the betterment of franchising. We have embraced the Franchising Code of Conduct, and we support the action the ACCC takes to address misconduct on the part of errant members of the sector. However it is clear from the information we have received from members that ACCC action is identified by many franchisors as their worst fear, and that participants in franchising are spending substantial resources on non-productive activities when those scarce resources would be better spent improving the profitability and well being of franchisees and the franchise system generally.

Couple the cost of defence with a huge fear of retribution by ACCC, and the sector that pre-S51AC produced 700,000 jobs and turnover of $81 billion is being significantly and unnecessarily impacted. Growth in the sector has slowed since the introduction of the Code, and franchisors fear the effects of the next economic downtown given the raft of legal remedies available to disgruntled franchisees and the interventionist attitude of the ACCC. It is ironic that the positive impact of the mediation based dispute resolution mechanisms contained in the Code is being counteracted by the actions of the prime sponsor of the Code.

We trust this submission assists the Committee in its important work, and would welcome the opportunity for further discussion on these critical matters.

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June, 2002

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