
Small business

The health of franchising from the viewpoint of its regulator



Following is an edited version of a presentation by Commissioner John Martin to the Franchise Council of Australia conference in Adelaide on 23 October 2001.

Introduction

My colleague Brendan Bailey and I welcome the opportunity to

participate with you all in this highly professional forum. Brendan will be known to many of you as the guru on franchising matters at the Commission.

The franchising sector's significance to the economy is demonstrated by its annual turnover of about \$81 billion and its extensive coverage of business types including specialist retailing, courier services, domestic cleaning and other services, lawn-mowing, real estate, lottery agents, auto parts and services, motor vehicle dealers, fast food, printing and petrol outlets.

Operation of the franchising code

The Commission plays an active role in administering and enforcing the franchising code of conduct through its powers under the Trade Practices Act. The mandatory code was introduced in July 1998 and became fully operational in October 1998.

The code appears to be generally working effectively and the health of the franchising industry appears generally sound. There is always room for improvement but the initial teething problems that followed the introduction of the code seem to have been addressed.

An important part of my role in the Commission is to present the small business perspective. As we know, franchisees and the majority of franchisors are technically small businesses. In the interests of the Australian economy our objective is to encourage small businesses to grow and prosper.

The Commission receives, on average, more than 2000 inquiries and complaints each quarter from small business. They cover the full range of matters dealt with under the Trade Practices Act.

Each quarter we receive more than 150 inquiries and complaints about franchising.

Leaving aside GST matters, the three main areas of franchising inquiry or complaint are:

- whether the code applies to a particular business relationship;
- obligations in the disclosure document and representations made by the franchisor; and
- the operation of the code, particularly for resolving disputes.

Legal action

Since the code began in 1998 only four code-related matters have resulted in a decision by the Commission to initiate formal litigation.¹ While all these matters are code-related they can also include allegations of other breaches of the Trade Practices Act. A franchisor, in its business dealings, must also comply with the other provisions of the Trade Practices Act including not engaging in restrictive trade practices and not misleading or deceiving consumers.

Some have argued that the Commission has been over zealous in looking at franchising when seeking to clarify the statutory provisions on breaches of the

¹ The Commission has successfully concluded litigation in *ACCC v Simply No Knead (Franchising) Pty Ltd* (2000) and *ACCC v Cheap As Chips Franchising Pty Ltd* (2001), and the recently initiated (but not concluded) proceedings in *ACCC v Suffolk Parke Pty Ltd* (2001) and *ACCC v 4WD Systems Pty Ltd* (2001).

code and unconscionable conduct in business transactions. However the Commission has not singled out franchising and its actions have only responded to complaints which were well investigated before action was taken. The Commission has also run significant unconscionable conduct cases on retail tenancy and, in the financial sector, has taken action against a major bank. A fourth major area of complaint currently under investigation is the dealings between primary producers and larger players further down the supply chain.

Commission processes

Given the misinformation surrounding some of the franchising court cases, it may be useful to explain how the Commission proceeds before deciding to take legal action.

The first step is to hold discussions with the franchisees and the franchisor to encourage them to resolve problems amicably. The Commission makes it clear that its initial role is to hear both sides.

It is reassuring that most parties tend to reach an understanding. When this is not possible the Commission steps aside to allow the parties to go to mediation. Only when there is no other option will the Commission take further action such as seeking a court enforceable undertaking from an offending party or in extreme cases going to litigation.

The decision on litigation is not taken lightly. The Commission has a formal process for considering each matter through its enforcement committee process.

It would be a serious mistake to assume that the Commission only sees matters through the eyes of the franchisees. That is not the case and it has never been. The Commission role is to apply regulatory measures without fear or favour consistent with common sense and proper commercial practices.

Coverage and compliance issues

The Commission notes the development of case law on franchising in Australia and overseas. These developments have helped clarify the law. We now await, with interest, judicial findings arising from private actions that will further clarify the definition of a franchise agreement under the code.² The

² See, for example, the decisions in *Agro Holdings Ltd v Flexi-Coil (Australia) Pty Ltd* [1999] and *Subway Systems Australia Pty Ltd v Michael John Thorpe* [2000].

Commission promotes a broad view of the code because it encourages better standards in business conduct — a goal that benefits franchisors, franchisees and ultimately the reputation of the sector with consumers.

The Commission was also mindful of the decision in the private action *Timic v Hammock* in the Federal Court of Australia in the Victorian Division in February 2001. The court found that an arbitration clause, as distinct from mediation under the code, could ultimately result in the removal of the matter to the home jurisdiction of the franchisor — which in that case was Connecticut in the United States. The decision in the *Timic* case resulted in a recent amendment to the code to make it clear that mediation, at least, must be conducted in Australia.³

I would point out that the Commission's role is not to decide the legal meaning of the provisions of the Trade Practices Act. That is the function of the courts. The courts in this country consistently deliver well-reasoned decisions. There was a positive outcome recently in the United States March 2001 decision of *Bolter v Superior Court*⁴ in which the California Court of Appeal held that an arbitration forum selection clause in a franchise agreement was unconscionable and unenforceable. In that case, the franchisee in dispute was facing relocation of an arbitration hearing from California to Utah with all the attendant additional costs.

While the Commission is responsible for administering the franchising code of conduct it does not determine policy. That role belongs to the Minister for Small Business supported by the Department of Employment, Workplace Relations and Small Business. The Commission does, however, become involved in how the code is applied in a practical sense. We welcomed the recent set of amendments to the code, effective from 1 October 2001, offering greater flexibility and streamlining of obligations under the code.

Assisting compliance

The Commission is mindful of the cost of compliance and seeks to work with the industry and the FCA (Franchise Council of Australia) to improve understanding and compliance with the code.

³ See amendment No. 34 in Statutory Rules: Trade Practices (Industry Codes — Franchising) Amendment Regulations 2001 (No. 1) 2001 No. 165.

⁴ *Bolter v Superior Court* 104 Cal Rptr. 2d 888 (9 March, 2001).

The Commission puts a lot of effort into consultation, participation in industry events such as expos and development of user friendly written material. Our publications include:

- *The franchisees guide: a guide to the Franchising code of conduct* which focuses on franchisee obligations and rights under the code.
- *The Franchising code of conduct compliance manual* which assists small to medium size franchisors in particular.

We aim for these products to complement the practical guides produced by the FCA. Both these Commission publications have been revised recently and are available on the ACCC website <<http://www.accc.gov.au>> as will be the latest version of the franchising code.

Assessing performance

The franchising code of conduct is seen by other business groups as an example of what could apply to them. The private sector has approached the Commission and Government about a similar mechanism to foster better business practices and investor confidence. As you know the preference of the present government is to support self-regulatory codes and only to have mandatory codes if the self-regulation approach is not working.

As part of its code responsibilities, the Commission recently reviewed the voluntary cinema code. We are also raising awareness across Australia of the voluntary retail grocery industry code of conduct, particularly how it applies to the supply of fresh produce to processors and the major retail chains. The Commission has also been recently made aware of suggestions for a national uniform retail tenancy code.

In a way it can be said the franchising sector leads the game. You have a code that is working and you have a good industry image.

Because of the cooperation and common sense displayed by your industry in supporting the code you have made the regulator's role more constructive in assisting investors and the industry as a whole.

Conclusion

Franchising remains the major pipeline for successful and growing small business. The peripheral 'dodgy' operators are coming under increasing pressure and steadily being weeded out.

My own experience has revealed franchisors who are in the main professional, innovative, proud of their achievements and highly supportive of their franchisees. This is a great recipe for continued success. The Commission looks forward to continuing to work constructively with the franchising sector.

Competing fairly forums: increasing support in rural Australia

The increasing popularity of the Commission's Competing Fairly Forums was demonstrated on 2 October 2001 by the increased number of venues across Australia. Participants gathered in 90 venues, 30 more than for the previous forum last May.

Audiences of small businesses, local government representatives, farmers, consumers and other interested parties came together in towns as dispersed as Bega and Broome, Albany and Alice Springs to take part in the satellite hook-up.

Media personality, George Negus, introduced an expert panel headed by Commission Chairman, Professor Allan Fels. The panel discussion centred around advertising and selling and some of the problems businesses and consumers can face if they are unaware of their rights and obligations under the Trade Practices Act.



Discussion was complemented by lively video scenarios that highlighted issues, such as product safety, misleading advertising and country of origin, which businesses or consumers face when advertising, selling and buying.

The panel also answered questions from participants in regional Australia. Many of these had been sent in before the broadcast via the forum website. Questions ranged from fine print disclaimers to advertising on the Internet.

Advertising and selling was chosen as the focus for the forum because truth in advertising, whether in print, on air or in speech means a fair go for consumers and businesses. A business that advertises phoney discounts and fails to display the full price is not only in breach of the law but is cheating competitors as well as consumers.

The forums are a significant and successful part of the Commission's campaign to increase understanding of the Trade Practices Act in rural and regional Australia. Greater understanding and compliance lead to a more efficient marketplace.

Although the Commission initiated the forums, credit for their success must also go to the support given by business and professional associations, local government and community groups.

By the end of the night the forum had delivered a strong, simple message to its audience. Before advertising, businesses should ask the following questions. What overall impression will the ad make? Is it likely to mislead potential customers?

For more information on the forums please ring the ACCC Infocentre on 1300 302 502 or visit the forum website at <<http://www.forums.accc.gov.au>>. Videos of the forums are also available from the Commission's publishing unit.

Commission recommends changes to film code

The Commission has completed its review of the code of conduct for film exhibition and distribution and made recommendations to improve its operation.

The review found that the code had led to more communication and discussion in the film industry than ever before. But it also found that some long-standing issues continued to concern many exhibitors. These included problems with film hire rates, minimum-season lengths and terms of supply, issues that have particularly concerned cinema operators in rural and regional communities.

The Commission has recommended changes to the code to address these concerns. For example, it has recommended that film hire rates should be referenced to the number of weeks after national release.

The review also acknowledged the special role of heritage-listed cinemas by recommending the inclusion of a scheme to allow such cinemas to operate more competitively.

The Commission remains a strong supporter of the code and has proposed these changes to ensure its effective operation. A full copy of the review is available on the Commission website.