New tougher laws proposed for the franchise sector in Australia following Parliamentary enquiry

April 8, 2019

Why are there proposals to change franchising law in Australia?

Australia’s Senate has finally released its report into the Australian franchising sector and it makes for uncomfortable reading.

The franchise sector covers franchise agreements as well as a range of intellectual property licences and distributorship arrangements and is, at present, primarily regulated by the franchising law, known as the Franchising Code of Conduct or Code.1 The sector contributes approximately nine per cent of gross domestic product (GDP) in Australia with around 80,000 franchise outlets turning over AU$146 billion.2 Around four per cent of small businesses in Australia are franchises and nearly half a million people are directly employed in the sector.3

Following a lot of negative press highlighting franchisee exploitation, the Australian Senate in 2018 referred an inquiry into the operation and effectiveness of the franchising laws to a Parliamentary Joint Committee on Corporations and Financial Services (Committee). The Committee’s 369-page report, following public hearings and extensive submissions from the sector, called “Fairness in Franchising” was released on 14 March 2019 (Report).

In a nutshell, the Committee found significant problems in the sector, including exploitation of franchisees and decided that the current regulatory environment “manifestly failed to deter systemic poor conduct and exploitative behaviour and has entrenched the power imbalance.” 4 The result is a range of recommendations to:

- make the regulation of franchising stronger and tougher;
- introduce new and higher penalties for breach of the franchising laws; and
- give the regulator, the Australian Competition and Consumer Commission (ACCC), more responsibilities and greater enforcement powers.

We set out below the key recommendations of the Committee for franchisors, franchisees and franchise systems in Australia. Although the Australian Government is yet to respond formally to the Report, if the recommendations are accepted and the changes are implemented, then the changes will materially impact the sector.

What are the key changes to the Australian franchising laws recommended by the Committee?

We summarise below the recommendations by the Committee which we think will most materially impact the franchising sector. The Committee made 71 recommendations in all but the summary below covers only those that we think will have the greatest implications for the sector.

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A) Unfair contract terms

Australia has general unfair contract terms legislation which operates to protect certain businesses entering into standard form contracts (UCT laws). Before the UCT laws, the ACCC reviewed a sample of franchise agreements to check compliance with the new laws and identified four common types of contract terms contained in franchise agreements that it considered could be problematic:

- the right to unilaterally vary operations manuals;
- liquidated damages clauses;
- restraints of trade; and
- termination clauses that grant a franchisor an unreasonable power to terminate.

The Committee found the UCT laws have had little impact on the franchising sector as the franchisee or the ACCC has to pursue court action to challenge a potentially unfair term and have it declared void.

Apply the UCT laws to franchise agreements regardless of whether the franchisee is a “small business”.

Introduce penalties for including unfair contract terms in franchise agreements.

Amend the Code to outlaw unilateral variation to the terms of a franchise agreement unless there is agreement by the majority of franchisees within the same franchise system or representatives elected by a majority of franchisees within the same franchise system.

The UCT laws will be widened to protect franchisees irrespective of the size and scale of the franchisee as they will no longer need to fall within the definition of a “small business”.

Franchisors should review their current franchise agreements to see if they are at risk of:

- parts of the agreement being deemed unfair and so unenforceable; and
- penalties down the track if the unfair term remains in the franchise agreement.

B) Pre-contract disclosure

The Committee found that an imbalance between franchisors and franchisees about the information relevant to the franchise system favours franchisors and so can hamper franchisees when they are conducting due diligence so they can make informed decisions about fees and other costs, contractual obligations and personal risks.

The Committee thought that this is particularly problematic where relevant

Require public registration of franchise systems and disclosure documents with the ACCC or other government authority. More frequent updates to the disclosure documents and template franchise agreements and require these to be included on the new register.

More disclosures covering:

- supplier rebates;

Any new registration process will increase the administrative burden on and costs of franchisors. There is a risk with more disclosures of inaccurate or misleading disclosures – which could lead to legal liability and litigation. Disclosure can be problematic also when the franchise model is not well enough established to provide the required disclosures.

Franchisors should monitor the development but not take action until the Australian Government’s reaction to the disclosure proposals are understood.
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<td>information cannot be obtained independently of the franchisor. The Committee though both the up-front disclosure and disclosure during the term of a franchise agreement were not adequate.</td>
<td>• franchisee profit margins and earnings; • marketing fund expenditures.</td>
<td>The power of franchisees to negotiate a collective bargain will dramatically change the power balance and alter the face of many deals, favouring franchisees. Franchisors will need to consider which of their systems are at greatest risk of franchisee collective action and monitor this development closely. Arbitration is often, but not always, preferred by franchisors and may not be less expensive than court action. Many franchisors will not find this recommendation as troubling as the proposals (discussed below) which hinder the franchisor's ability to take court action – whether injunctive or not - as inhibiting the franchisor's right to obtain urgent interim relief when the brand's reputation is at stake may impact the value of the brand and the franchisor's intellectual property rights.</td>
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<td>C) Dispute resolution</td>
<td>Include binding arbitration in the Code’s dispute resolution process. Prohibit taking legal action until alternative dispute resolution is complete unless, if a franchisor takes a matter to court, the franchisor demonstrates to the court’s satisfaction that the matter cannot be resolved through mediation. Permit franchisees to collectively bargain with the franchisor.</td>
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<td>D) Termination rights</td>
<td>Extend the franchisee’s right to terminate the franchise agreement during the cooling off period to transfers, renewals and extensions. Lengthen the cooling off period from 7 to 14 days. Provide a new right for franchisees to terminate the agreement without liability to the franchisor if the franchisee is suffering from “personal hardship”, making a loss or if</td>
<td>The proposed changes to the cooling off period are unlikely to trouble many franchisors as they will simply plan for the right to be triggered. Mandating additional franchisee rights to terminate agreements will be of greatest concern to franchisors especially if there is any ambiguity as to how the trigger for “personal hardship” on the part of the franchisee would work. Franchisors will be concerned if the right is a way for franchisees to escape liability to the franchisor when the franchisee has been poor performers because of their own franchisee profit margins and earnings; marketing fund expenditures.</td>
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The Report also noted that exit arrangements do not provide a way for franchisees to exit an unviable franchise that is fair to both parties and in a way that reasonably constrains financial losses and franchisor risks are low on franchisee early exit as franchisor losses are covered but that the franchisee could be bankrupted.

The Committee thought that rights should also exist for franchisees to terminate franchise agreements where a franchisor is subject to special circumstances such as franchisor insolvency but that franchisors are unlikely to voluntarily include such rights in franchise agreements. The Committee also thought that there was a risk of franchisor abuse (and so recommended constraining the right of the franchisor to terminate the agreement) of the franchisor's rights to terminate the franchise agreement when the franchisee:

- acts in a way that endangers public health or safety; or
- acts fraudulently,
as there was too much franchisor discretion as to what constitutes a breach, rather than the determination being made by an independent decision-maker.

Restrict franchisors from exercising rights to terminate the franchise agreement for franchisee fraud or endangerment of public health or safety unless:

- the franchisee is actually convicted of fraud; or
- the franchisee is served with a 'permanent closure direction' for the franchise by a relevant government body, or failure to remedy workplace health and safety orders or notices where the issue is the franchisee action has endangered public health or safety.

Franchisors with systems and brands to protect will be very concerned if they are restricted from terminating a franchisee who has committed a fraud or endangered public health or safety until court or regulatory processes (which might take years) are complete.

A restriction on the right will severely impact the franchisor's ability to mitigate the risk of harm to its reputation. Franchisors should monitor this development very closely.

E) Penalties

Finally and unsurprisingly, the Committee recommended higher penalties for breaches of the Code as well as new protections for whistle blowers and more power for the ACCC to intervene.

What next?

The Report awaits the Australian Government’s formal response to its proposals. Many recommendations are controversial however it is inevitable there will be changes to Australia’s franchising laws – and they may be significant.
For now, franchisors, franchisees and franchise systems in Australia, and those also with distribution and intellectual property licensing arrangements in Australia (* which can be caught by the laws) should monitor the developments closely.

It is unlikely that any formal response to the Report or draft legislation will be in place before mid-2019.

Please contact Robyn Chatwood, Partner in the Dentons Australian Franchise practice group, or your usual Dentons contact if you need further information or wish to be added to our list to receive updates on the developments.

1. Formally called the Competition and Consumer (Industry Codes—Franchising) Regulation 2014 (Cth).


3. As above.

4. Item 2 at p xxii.

5. The UCT applied from 12 November 2016 through the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (Cth). Under Australian Consumer Law (ACL), “small businesses” are provided with some protection from the abuse of unfair terms contained in such contracts.

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