



Motor Trades Association of Australia

Mr Graeme Matthews
Chairman
Review of the Franchising Code of Conduct
Office of Small Business
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2600

By email: Franchise.Review@industry.gov.au

Dear Mr Matthews

Please find attached a copy of the Motor Trades Association of Australia's (MTAA's) submission to the Review of the Franchising Code of Conduct ('the Review').

The Motor Trades Association of Australia (MTAA) is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association is the largest 'stand-alone' small business association in Australia, representing over 100,000 businesses in a sector which turns over more than \$120 billion each year and employs over 316,000 people. The use of franchising is widespread in many areas of the retail, service and repair sector, including new motor vehicle retailing, farm and industrial machinery retailing, vehicle rental and petroleum retailing. MTAA therefore has a strong interest in franchising matters and welcomes the opportunity to make a submission to the Review.

MTAA considers that the disclosure provisions of the Code have played an important role in changing the behaviour in the franchising industry and in ensuring that franchisees are fully informed about any material issues which may affect their decision to enter into or renew a franchise agreement or which may affect their franchised businesses. That said however the Association considers that there are some weaknesses in the current disclosure provisions.

In particular, MTAA considers that the Code needs to be strengthened to ensure that franchisors provide accurate and up-to-date disclosure documents to franchisees on a regular basis. MTAA also considers that disclosure documents should include information about the potential impact on the franchisee if the franchisor becomes insolvent or is placed in administration. Disclosure documents should also include information about the potential for a change in ownership or control of the franchisor to occur during the term of the franchise agreement and the impact that such a change may have on the franchisee. MTAA also believes that disclosure documents should include more detailed information about certain matters, including performance obligations, marketing strategies and capital expenditure. In MTAA's view, the Code requirements in respect of the disclosure of materially relevant facts also need to be strengthened to enable this information to be provided to franchisees in a more timely manner.

Motor Trades Association House, 39 Brisbane Avenue, Barton ACT 2600
PO Box 6273, Kingston, ACT 2604
Telephone: + 61 2 6273 4333. Facsimile: + 61 2 6273 2738.
Email: mtaa@mtaa.com.au A.B.N. 66 008 643 561

I trust that these comments are of assistance in your consideration of this matter and I would be happy to discuss these matters further with you at your convenience.

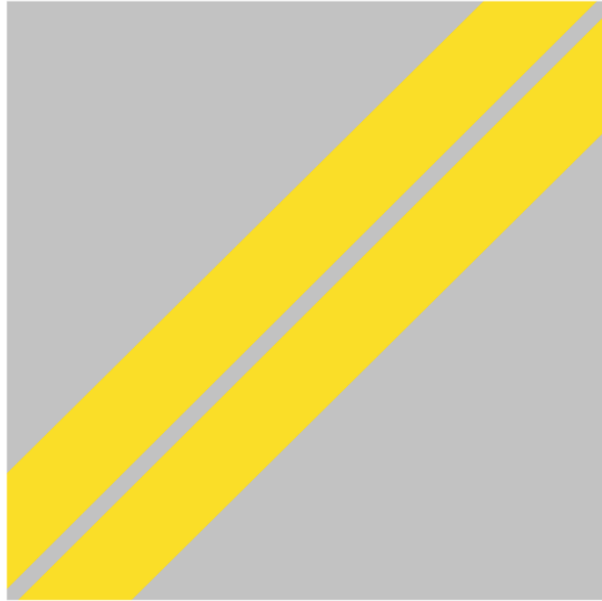
Yours sincerely

A handwritten signature in black ink that reads "Michael Delaney". The signature is written in a cursive style with a large initial 'M' and a long, sweeping tail on the 'y'.

MICHAEL DELANEY
Executive Director

15 August 2006

MOTOR TRADES ASSOCIATION OF AUSTRALIA



**SUBMISSION TO THE
REVIEW OF THE FRANCHISING CODE OF CONDUCT**

AUGUST 2006

TABLE OF CONTENTS

Executive Summary	1
1. Introduction	3
1.1 Overview of the Motor Trades Association of Australia (MTAA)	3
1.2 MTAA’s Interest in the Review	5
2. General Matters	5
2.1 Code Requirements in relation to the Provision of Disclosure Documents to Existing Franchisees	6
2.2 Code Requirements in relation to the Veracity of Information Contained in Disclosure Documents	7
2.3 Code Requirements in relation to the Disclosure of Materially Relevant Facts	8
3. Information Included in Disclosure Documents.....	8
3.1 Information About the Potential Consequences if the Franchisor Becomes Insolvent or is Placed in Administration.....	8
3.2 Change in Ownership or Control of the Franchisor	11
3.3 Marketing Strategies and Performance Obligations	12
3.4 Capital Expenditure	13
3.5 Dispute Resolution.....	13
4. Other Issues	14
5. Conclusion.....	17

Executive Summary

The Motor Trades Association of Australia (MTAA) is the peak national representative organisation for businesses in the retail, service and repair sector. The use of franchising is widespread in the sector and therefore many of businesses that MTAA represents are franchised. MTAA therefore has a strong interest in franchising matters and welcomes the opportunity to make a submission to the Review of the Franchising Code of Conduct ('the Review'). As MTAA understands matters, the Review will focus on the disclosure provisions of the Franchising Code of Conduct ('the Code'). In its submission, MTAA will therefore focus on certain aspects of those provisions and will consider whether there is merit in amending the current provisions.

MTAA considers that while the disclosure provisions of the Code have improved the level of information that is provided to franchisees, there are still some significant weaknesses in current disclosure regime. In particular, the Association considers that the Code needs to be strengthened to ensure that the information contained in disclosure documents is accurate, up-to-date and meets the requirements of the Code. The Association believes that the inclusion of requirement for franchisors to lodge a copy of their current disclosure document with the Australian Competition and Consumer Commission on an annual basis would provide franchisors with a strong incentive to ensure that information included in their disclosure documents is accurate and up-to-date.

The Association also considers that the Code needs to be strengthened to require franchisors to provide franchisees with a copy of their current disclosure document within a reasonable period after the end of each financial year and at all times where there has been a change in a materially relevant fact. MTAA believes that such an approach would help to ensure that franchisees are fully informed of materially relevant information on a regular basis.

MTAA is also concerned about the Code requirements in relation to the disclosure of materially relevant facts. In light of the material nature of these facts and the potential impact they may have on the franchisee's business, MTAA considers that the Code should be amended to reduce the period of time in which the franchisor must notify franchisees of materially relevant facts from sixty days to fourteen days.

In terms of the information that is included in disclosure agreements, MTAA considers that there are some weaknesses in the current requirements under the Code. In particular, the Association considers that disclosure documents should contain more information about the potential consequences for the franchisee of the franchisor's insolvency or administration, as these events may potentially have a significant impact on the franchisee's business arrangements and the long-term viability of the franchisee's business. The Association also considers that

disclosure documents should also include information about the impact of a change in ownership or control of the franchisor. MTAA considers that the inclusion of this information in disclosure documents will help to ensure that potential and existing franchisees are fully aware of these potential risks and can develop an appropriate risk management strategy for their business

In MTAA's view, disclosure documents should also include more detailed information about some matters, including marketing and sales strategies, the franchisor's procedures for the setting of performance targets, any potential capital expenditure requirements under the agreement (in addition to those required to set up the business) and the cost of the Code's dispute resolution processes. MTAA considers that the inclusion of this information will help to ensure that franchisees have a good understanding of the franchisor's policies, procedures and strategies prior to entering into or renewing their agreements. This improved information may in turn help to reduce the likelihood of disputes arising between the franchisor and the franchisee.

MTAA's submission also addresses a range of other issues which it believes are not adequately addressed in Code, including minimum tenure, termination at will without due cause and the unilateral variation of franchise agreements.

MTAA therefore considers that while the disclosure provisions of the Code have improved the level of information that is provided to franchisees, there are still some significant weaknesses in current disclosure regime.

1. Introduction

The Motor Trades Association of Australia (MTAA) welcomes the opportunity to make a submission to the Review of the Franchising Code of Conduct ('the Review'). As MTAA understands matters, the Review will focus on the disclosure provisions of the Franchising Code of Conduct ('the Code'). MTAA's submission will therefore examine certain aspects of the operation of those provisions and will also consider whether there is merit in amending the current provisions. This submission will also however, address some other aspects of the Franchising Code of Conduct which the Association believes warrant further consideration by this Review.

1.1 Overview of the Motor Trades Association of Australia (MTAA)

MTAA is the peak national representative organisation for the retail, service and repair sector of the Australian automotive industry. The Association represents the interests, at the national level, of over 100,000 retail motor trade businesses with a combined turnover of over \$120 billion and which employ over 316,000 people. MTAA is therefore the largest 'stand-alone' small business association in Australia. The Association is a federation of the various state and territory motor trades associations and automobile chambers of commerce, as well as the New South Wales based Service Station Association Ltd (SSA) and the Australian Automobile Dealers Association (AADA). MTAA also has a number of Affiliated Trade Associations (ATAs), which represent particular sub-sectors of the retail motor trades, ranging from motor vehicle body repair to automotive parts recycling. Those ATAs are as follows:

- Australian Motor Body Repairers Association (AMBRA)*
- Australian Motorcycle Industry Association (AMIA)*
- Australian National Radiator Repairers Association (ANRRA)*
- Australian National Towing Association (ANTA)*
- Australian Service Station and Convenience Store Association (ASSCSA)*
- Australian Tyre Dealers and Retreaders Association (ATDRA)*
- Auto Parts Recyclers Association of Australia (APRAA)*
- Automotive Repairers Association of Australia (ARAA)*
- Automotive Transmission Association of Australia (ATAA)*
- Engine Reconditioners Association of Australia (ERA of A)*
- Farm and Industrial Machinery Dealers Association of Australia (FIMDAA)*
- National Brake Specialists Association (NBSA)*
- National Heavy Vehicle Repairers Association (NHVRA)*
- National Rental Vehicle Association (NRVA)*
- National Steering and Suspension Association (NSSA)*
- National Vehicle Airconditioning Association (NVAA)*

All of the ATA's listed above are composed of the relevant sections of each of the MTAA Member bodies and are represented, at a national level, by MTAA.

The Association's affairs are directed by a Board on which each of MTAA's Member bodies is represented. The role of the Association is to:

- raise awareness in the community of the retail motor trades' significant contribution to the Australian economy (the trades have a turnover of over \$120 billion and employ over 316,000 people);
- convey and promote to governments the interests of the retail motor trades;
- promote improved working relationships and practices with the motor trades' unions;
- on behalf of the Members of the Association, provide information about the trades to governments, the public and the trades' employees;
- work with governments to plan the future of the retail motor trades and their role in the economy and other areas of national planning;
- extensively enhance training and to develop work opportunities within the trades in co-operation with education and training authorities, the unions and government generally; and
- promote and enhance the reputation of the trades with its customers and the general public.

The range and depth of the activities of the membership of the Association can be seen from the following list of recognised trades, skills and tasks in the retail, service and repair sector of the automotive industry:

Air-conditioning Technicians	Dynamometer Operators
Auto Electricians	Engine Fitters
Automotive Accessory Retailers	Engine Performance Specialists
Automotive Dismantlers/Parts Recyclers	Engine Reconditioners
Automotive Engineers	Exhaust System Specialists
Automotive Glass Fitters	Farm Machinery Dealers
Automotive Parts Cataloguers	Fuel Injection Specialists
Automotive Radio and Stereo Specialists	Gas Fitters
Automotive Service Managers	Hire and Rental Vehicle Operators
Automotive Trimmers	Marine Automotive Engineers
Automotive Upholsterers	Motor Boat and Marine Dealers
Automotive Transmission Specialists	Motorcycle Dealers
Battery Makers and Reconditioners	Motorcycle Mechanics

Body Builders	Motor Mechanics
Brake Specialists	Panel Beaters
Car Alarm Fitters	Petrol Pump Attendants
Caravan Dealers	Radiator Repairers
Car Dealers	Spray Painters
Car Salespeople	Tow Bar and Trailer Fitters
Car Wash Operators	Tow Truck Operators
Chassis Builders and Repairers	Truck Builders and Operators
Commercial Vehicle Body Fabricators	Tuning Specialists
Detailers	Tyre Fitters
Diesel Engineers	Tyre Retreaders
Diesel Injection Technicians	Wheel Alignment Specialists

1.2 MTAA's Interest in the Review

The use of franchising is widespread in many areas of the retail, service and repair sector of the Australian automotive industry, including the new motor vehicle retailing, farm and industrial machinery retailing, vehicle rental and petroleum retailing sub-sectors of the industry. Franchised businesses in the sector also represent a significant proportion of all franchised businesses in Australia.

MTAA, as the peak national representative organisation for businesses in the retail motor trades, therefore has a strong interest in franchising matters. MTAA has, since its establishment, actively sought to improve the relationship between franchisees and franchisors in the retail motor trades and to ensure that the interests of franchisees are adequately protected. In particular, the Association advocated and supported the development and introduction of the mandatory Code. What MTAA sought from the introduction of the mandatory Code was a change in the behaviour of franchisors. The Association believes that the disclosure provisions are an important tool in securing that change and that pre-contractual disclosure is an element of the Code and MTAA therefore has a strong interest in the matters that are to be examined as part of the Review.

While MTAA acknowledges that since the introduction of the Code in 1998 there has been a change in the behaviour of franchisors in general, the Association is in no way suggesting that the Code has been a panacea for all of the issues that arise from time to time between franchisors and franchisees. MTAA in fact believes that there is a case for strengthening the Code.

2. General Matters

As note above, MTAA strongly supported the introduction of the mandatory Franchising Code of Conduct. The Association believes that the Code has been

successful in improving business practices in the franchising industry and in some areas of their dealings, the relationships between franchisors and their franchisees. The disclosure provisions in particular have helped potential franchisees and renewing franchisees to make informed decisions about whether to enter into or renew a franchise agreement. The Code has also helped, to some degree, to ensure that franchisors disclose to their franchisees any materially relevant matters which arise during the term of the franchisees' franchise agreements. MTAA is however concerned about some apparent weaknesses in the Code's disclosure provisions and those concerns are discussed in more detail below.

2.1 Code Requirements in relation to the Provision of Disclosure Documents to Existing Franchisees

MTAA has some concerns about the sections of the Code which deal with the provision of disclosure documents to existing franchisees. Under the Code, franchisors are currently required to give a disclosure document to an existing franchisee if the franchisee intends to renew or extend their franchise agreement (Clause 6B) or if the franchisee requests a copy of that document in writing (Clause 19). In the latter circumstance, the franchisee is only allowed to make such a request once every twelve months; after such a request the franchisor has 14 days to provide the franchisee with a current disclosure document.

MTAA is concerned that placing the onus on franchisees to request a copy of the disclosure document may deter some franchisees from exercising their right to request a copy of the franchisor's disclosure document. This is because some franchisees may believe, reasonably or unreasonably, that their relationship with their franchisor may be adversely affected if they exercise their right under Clause 19 (that is, a franchisee may fear being labelled as 'difficult' or a 'trouble maker' by their franchisor). This fear is likely to be particularly real for franchisees who have recently been, or are currently involved in, a dispute with their franchisor. MTAA also understands that some franchisees may not be aware of their right to obtain a copy of their franchisor's current disclosure document or may simply not have the time to request a copy of that document because they are too busy attending to other more important aspects of their businesses.

While MTAA acknowledges that franchisees need to take responsibility for their own affairs, the Association is concerned that the requirement for franchisees to request a copy of the relevant disclosure document, coupled with the limitation on the number of times a franchisee can make such a request, may disadvantage some franchisees. This is because franchisees will usually not be aware that their franchisor has recently updated, or is about to update, its disclosure document and are therefore not in a position to time their request so that they receive an up-to-date version of the disclosure document.

In light of the important information contained in the disclosure document, including information about marketing strategies, pricing policies and performance obligations, MTAA considers that franchisees should receive an updated disclosure document from

their franchisor on an annual basis, without any requirement for the franchisee to request the provision of the document. MTAA would therefore suggest that Clause 19 should be amended to require franchisors to provide a copy of their current disclosure document to their franchisees within a reasonable period after the end of each financial year and at all times where there has been a change in a materially relevant fact.

In addition, MTAA believes that it would assist franchisees if a relevant third party, such as representative association, could issue a request to a franchisor, for a copy of a current disclosure document. This would assist in overcoming individual franchisee's concerns about retribution from a franchisor where an individual is required to make the request for a disclosure document.

2.2 Code Requirements in relation to the Veracity of Information Contained in Disclosure Documents

As MTAA understands matters, there are currently no procedures in place to check the veracity and timeliness of information provided to franchisees in disclosure documents. MTAA considers that the lack of such procedures may encourage some franchisors to take a relaxed view of the Code's requirements in relation to the maintenance and accuracy of disclosure documents, as inaccurate or dated information is unlikely to be discovered or reported unless there is a dispute between the franchisor and one or more of its franchisees.

In light of the fact that the information contained in the disclosure document is central to many potential and existing franchisees' decisions to enter into or renew a franchise agreement, MTAA believes it is very important that that information is both accurate and up-to-date. This is particularly so given the significant investment many franchisees make in their businesses. MTAA therefore considers that it is important that there is some mechanism by which the veracity and timeliness of information included in disclosure documents is reviewed.

In that regard, MTAA would suggest that Division 2.1 of the Code could be amended to include a clause which requires franchisors to lodge a copy of their general disclosure document (the template document which forms the basis of the specific disclosure documents provided to its franchisees) with the Australian Competition and Consumer Commission (ACCC) on an annual basis. The ACCC should then be requested by the Minister to audit, at a minimum, a random sample, each year, of the disclosure documents lodged with it to check the accuracy and currency of the information provided in those documents and for compliance with the Code's disclosure requirements. MTAA considers that such an approach would provide a significant incentive for franchisors to ensure that the information provided in their disclosure documents is up-to-date and accurate and that those documents complied with the requirements of the Code.

2.3 Code Requirements in relation to the Disclosure of Materially Relevant Facts

Under Clause 18 of the Code, franchisors are required to disclose materially relevant facts to their franchisees within sixty days of becoming aware of those facts. Facts which are materially relevant for the purposes of the clause include changes in the majority ownership or control of the franchisor, the outcomes of certain criminal or civil legal proceedings, changes related to the intellectual property that is material to the franchise system and the franchisor becoming an externally-administered corporate.

MTAA notes that all of these circumstances have the potential to have a significant impact on franchisees' businesses and investment decisions (in particular, where a franchisee is considering entering into or renewing a franchise agreement) and the Association therefore believes that it is not acceptable that franchisors are only required to advise franchisees and potential franchisees of these material facts within sixty days of becoming aware of them. In light of the material nature of these facts, MTAA considers that it would be more appropriate if franchisors were required to disclose such facts to their franchisees within fourteen days of becoming aware of them. The Association therefore recommends that Clause 18 be amended to reduce maximum disclosure period from sixty days to fourteen days. MTAA understands that this amendment has in fact been under active consideration by the Office of Small Business for a number of years now and would comment that this issue must now be addressed as a matter of urgency.

In fact it should be noted that in relation to some of the sub-clauses in this clause 18 of the Code the requirement to advise franchisees of a material change only applies after the change has occurred (for example in relation to the change of ownership or change in the ownership of the intellectual property). MTAA believes that serious consideration should be given to amending this clause to provide that franchisors are required to advise franchisees of a potential change in materially relevant facts as soon as the franchisor becomes aware of that prospect.

3. Information Included in Disclosure Documents

3.1 Information About the Potential Consequences if the Franchisor Becomes Insolvent or is Placed in Administration

The insolvency of a franchisor can have a significant impact on the financial performance and viability of its franchisees' businesses. In such circumstances, franchisees may face a range of problems including the loss of access to necessary intellectual property, the loss of their business premises (in circumstances where the franchisor either owns or has entered into the lease for the franchisee's business premises), financial losses and potentially the loss of their business. In light of the significant ramifications for franchisees in the event

that their franchisor becomes insolvent, MTAA is concerned that the disclosure provisions of the Code may not provide sufficient information about the impact that such an insolvency would have on the business affairs of the franchisee.

In particular, the Association considers that it would assist franchisees if the franchisor was required to disclose to potential (and existing) franchisees the possible impact that any insolvency of the franchisor would have on certain key aspects of the franchisee's business including branding/intellectual property, the franchisor's supply of goods and services, any leases entered into under the franchise agreement and any right of the franchisee to terminate the agreement in the event of the franchisor's insolvency. These issues are discussed in more detail below.

Intellectual Property

Branding and intellectual property are central to the success of most franchised businesses as those businesses are frequently reliant on the franchisor's brand, business systems and products to attract customers and sales and to therefore remain financially viable. In the event of the franchisor's insolvency however it is possible that its franchisees may lose the right to use its intellectual property. Given the importance of that intellectual property to the franchisees' businesses, it is likely that such a loss is likely to have significant ramifications for franchisees and the continued financial performance and viability of their businesses.

In light of the essentiality of a franchisor's intellectual property to the continued success of many franchised businesses, MTAA believes that franchisees should be made aware of the potential impacts that the insolvency of their franchisor may have on their ability to access the franchisor's intellectual property. The disclosure of such information in the disclosure document will help to ensure that franchisees are fully informed of a key risk to the continued success of their business and enable franchisees to put contingency plans in place to deal with the risk in the event that it materialises.

Supply of Goods and Services

The franchisor's continued supply of its goods and services may also be central to the continued success of many franchised businesses. In the event that a franchisee's franchisor becomes insolvent, there is a real possibility that the franchisee may not be able to secure a supply of the franchisor's products and services and that would obviously have a significant impact on the franchisee's business. For example, the failure of the manufacturer and distributor of Rover motor vehicles resulted in motor vehicle dealers who held Rover franchises being unable to secure a long-term supply of Rover products which in turn resulted in the dealers losing their Rover franchises.

In light of the major impact that insolvency may have on the franchisor's ability to supply its goods and services to its franchisees, the Association considers that franchisors should be required to disclose that potential risk in their disclosure documents. Such a disclosure

would, in MTAA's view, ensure that franchisees were fully informed of the potential risk and that would assist franchisees in developing and operating a risk management strategy for their businesses.

Leases

MTAA also notes that the insolvency of a franchisor may have a significant impact on the lease arrangements of its franchisees, as it is not uncommon for the franchisor to hold the head lease for the franchisee's premises. In the event of the franchisor's insolvency, it is therefore possible that the lessor may terminate its lease with the franchisor and choose not to enter into a new lease with the affected franchisee. In such circumstances, the franchisee would be required to vacate the premises and to locate alternative premises from which to conduct their business.

In the event that the franchisee succeeds in locating a suitable premises, it is likely that it will incur substantial costs to relocate to its new premises as it will probably need to fit out those premises and to relocate stock to the new location. It is also possible that the franchisee may be unable to secure another suitable location from which to operate their business and in those circumstances it is likely that the franchisee will be forced to walk away from their business or to sell it at a greatly reduced price (noting that the insolvency of the franchisor and the lack of business premises are likely to have a negative impact on the prospect of a successful sale).

In light of the significant impact that the loss of business premises may have on the financial viability of a franchisee's business, the Association believes that, in circumstances where the franchisor holds the head lease for the franchisee's business premises, the franchisor should be required to clearly disclose the risks associated with such an arrangement in the event of the franchisor's bankruptcy. This requirement would go beyond the current requirements set out in clause 14 of the Franchising Code.

Termination of Agreement

MTAA understands that during the relatively recent failure of Traveland, some of its franchisees obtained legal advice which indicated that they were not entitled to terminate their franchise agreements as a result of the insolvency of their franchisor. MTAA notes that the ability of a particular franchisee to terminate their franchise agreement in the event of their franchisor's insolvency will be dependent on the terms of their franchise agreement and is therefore likely to vary from franchisee to franchisee.

MTAA considers that the inability to terminate a franchise agreement in the event of the franchisor's insolvency will place significant constraints on the franchisee and that it should therefore be clearly disclosed to the franchisee prior to their entry into the franchise agreement.

Other Matters

MTAA notes that the insolvency of a franchisor is likely to have a significant effect on its franchisees. It is possible that franchisees may need to make significant modifications to their business arrangements in response to such an insolvency and that those modifications may impose substantial costs on the franchisee, which the franchisee may be unable to meet. It is also a real possibility that the insolvency of the franchisor may result in the franchisee being unable to continue operating their business.

There are therefore some very significant risks for franchisees in the event that their franchisor becomes insolvent. In light of the very serious nature of those risks, MTAA considers that those risks should be clearly spelt out in the disclosure document provided to franchisees prior to their entry into, or renewal of, their franchise agreement. Such an approach ensures that franchisees are fully informed of those risks and it enables them to consider those risks in the context of their risk management strategy for their business.

3.2 Change in Ownership or Control of the Franchisor

MTAA notes that the owners of the franchisor are usually free to sell some or all of their interest in the franchisor without consulting the franchisor's franchisees or seeking their approval for the sale. In the event that the owner(s) of the franchisor decides to sell the business or the majority of its interest in the business, the franchisor is required under the Code to advise its franchisees of the change in its ownership or control. This matter has been commented on in section 2.3 above.

While MTAA acknowledges that requirement, the Association considers that it may be useful if disclosure documents included a statement to the effect that the ownership or control of the franchisor may change during the term of the agreement and that the franchisee has no right to be consulted about or to veto the change in ownership. Such a statement would ensure that franchisees were fully informed of the possibility that the ownership of the franchisor may change during the course of the agreement and that the franchisee will not be able to influence that change in ownership.

MTAA also notes that the new owners of a franchise may have different expectations for the business and may therefore institute some fairly significant changes to their business arrangements. It is possible that those changes may have a considerable impact on franchisees, as the franchisor may alter their performance targets, marketing strategies and pricing policies. MTAA therefore considers that disclosure documents should include a statement which advised franchisees of the possibility that a change in the ownership or control of the franchisor may result in material changes to the business arrangements between the franchisor and its franchisees.

3.3 Marketing Strategies and Performance Obligations

The marketing strategies utilised by a franchisor have the potential to have a significant impact on the businesses of its franchisees. In particular, strategies such as discriminatory pricing (that is, where the franchisor provides the same stock to different franchisees at different prices) or distress marketing (where the franchisor provides stock to a franchisee at a discounted price without re-pricing similar stock held by another franchisee) have the potential to place some franchisees at a competitive disadvantage and that may affect the financial performance of those franchisees' businesses. Those marketing strategies also have the potential to contribute to instability in the market for the relevant product, which may also have a negative impact on franchisees. In light of that, MTAA believes that franchisors should be required to disclose in the disclosure document that they intend to use such marketing strategies and that their use of those strategies may have a detrimental impact on the franchisee's business. MTAA also considers that franchisors should also be required to disclose their policies and procedures in that regard as this will help to ensure that the franchisor operates in a transparent manner and that franchisees have a good understanding of, and confidence in, the franchisor's decision-making processes in relation to this issue.

MTAA also notes that performance and sales targets are an important issue for many franchisees and franchisors and that those targets can also frequently give rise to disputes between franchisees and franchisors. MTAA therefore suggests it may be useful if disclosure documents provided more detailed information on the manner in which the franchisor will determine sales and performance targets (for example, will it consider local market factors in determining a franchisee's performance targets) and the circumstances under which such targets can be altered/varied, as the provision of such information will provide franchisees with a better understanding of how their performance targets are determined and may therefore reduce the likelihood of disputes between franchisees and franchisors.

MTAA also considers that it is important that franchisors be required to disclose the sales strategies they have under consideration to a potential or existing franchisees prior to entering into or renewing a franchise agreement. MTAA believes that such disclosure is warranted because the introduction of those strategies by the franchisor may have a significant impact on the ability of the franchisee to meet its sales performance obligations under the agreement. For example, the decision by a motor vehicle manufacturer to sell vehicles directly to government and to pay the franchisee a flat fee for the delivery of those vehicles would likely impact upon the ability of a franchisee to meet its sales targets under the agreement. It is therefore important, in MTAA's view, that franchisor discloses the fact that such strategies are under consideration as this will enable the potential or existing franchisee to make a fully informed decision as to whether to enter into or renew a franchise agreement.

3.4 Capital Expenditure

MTAA is aware that some franchise systems may require franchisees to undertake significant capital expenditure during the term of the franchise agreement (in addition to the initial investment the franchisee has undertaken at the commencement of the agreement). For example, motor vehicle dealers may be required to upgrade or build new display premises as a result of the introduction of new brand livery or a decision of a franchisor to introduce or raise existing conditions in franchise agreements about the appearance of premises. The costs incurred by the franchisee to meet those requirements may be substantial and the Association therefore considers that franchisees should be fully informed of their potential obligations in this regard prior to their entry into the franchise agreement. This is because the level of capital expenditure the franchisee may be required to undertake during the term of the agreement is likely to influence their decision about whether to enter into or renew the franchise agreement. MTAA therefore believes that franchisors who may require their franchisees to undertake significant capital expenditures during the term of the franchise agreement should be required to clearly disclose those requirements in the disclosure document. MTAA would also say that in this regard, the term of a franchise agreement should be sufficient to enable franchisees to earn a return on that capital invested.

MTAA also notes that in some cases the franchisee may be required to contribute to the cost of branding the business, but the ownership of the branding will remain with the franchisor. For example, MTAA understands that some motor vehicle manufacturers require franchisees to contribute fifty per cent of the cost of signage for the franchisee's premises, but the motor vehicle manufacturer actually retains the ownership of the signage. In those circumstances, MTAA considers that the franchisor should be required to disclose that although the franchisee will contribute to the cost of branding, the franchisor will retain ownership of the signage.

3.5 Dispute Resolution

MTAA notes that the Code includes a dispute resolution process and that under that process franchisees and franchisors may engage the services of a mediator to resolve a dispute. Under the Code, the costs of that mediation are to be shared equally and the parties must also pay their own costs of attending the mediation. While disclosure documents must include information about the Code's dispute resolution process, there is currently no requirement for those documents to state that the costs associated with mediation may potentially be quite substantial. In light of the fact that franchisees will be required to pay half of those costs and that most franchisees have no knowledge about the cost of mediation, MTAA considers that they should be advised of the fact that those costs may potentially be quite substantial.

4. Other Issues

There are a number of other issues that MTAA believes are not adequately addressed in the Franchising Code of Conduct. In particular, the Association is concerned that the Code does not proscribe the termination of franchise agreements at will without due cause or the unilateral variation of franchise agreements.

Definition of Franchise Agreement

MTAA is concerned that the definition of ‘franchise agreement’ in the Code is not sufficient to ensure that all franchise arrangements fall within the scope of the Code. While MTAA acknowledges that it is important that the Code does not inadvertently capture commercial arrangements which are clearly not franchising arrangements, the Association is concerned that the definition of ‘franchise agreement’ contained in subclause 4(1) of the Code is not sufficiently wide enough to capture all franchise relationships in the retail motor trades. In particular, MTAA is concerned that it is relatively easy for franchisors to structure their agreements in a manner which enables them to avoid coverage under the Code even though those agreements are, for all intents and purposes, franchise agreements.

The Association is also concerned about subclause 5(3)(c) of the Code which exempts some franchise agreements from coverage under the Code. Under that subclause, an agreement which meets the definition of a franchise agreement in subclause 4(1) of the Code will be exempt from coverage under the Code if:

- (i) *the franchise agreement is for goods or services that are substantially the same as those supplied by the franchisee before entering into the franchise agreement; and*
- (ii) *the franchisee has supplied those goods or services for at least two years immediately before entering into the franchise agreement; and*
- (iii) *sales under the franchise are likely to provide no more than twenty per cent of the franchisee’s gross turnover for goods and services of that kind for the first year of the franchise.*

Under subclause 5(4) of the Code, subclause 5(3)(c) will cease to apply to a franchise agreement if sales under the franchise agreement represent more than twenty per cent of the franchisee’s gross turnover for the goods and services for three consecutive years and the franchisee advises the franchisor of that fact.

MTAA understands that many franchised businesses in the retail motor trades experience low sales in their initial years, as the franchisee builds its client base and goodwill. MTAA also understands that some franchisees in the retail motor trades (in particular, new motor vehicle dealers) may hold multiple franchises. The Association is concerned therefore that, despite the fact many of those franchisees have made significant investments in their franchise businesses, their agreements may not fall within the scope of the Code. MTAA believes that such an outcome is unacceptable

and unjustified. The Association considers that all agreements which meet the definition of ‘franchise agreement’ contained in the Code should be subject to the provisions of the Code irrespective of the number of franchises held by the franchisee or the percentage of gross turnover that the franchisee will derive from the franchise.

Mandated Minimum Tenure

Many franchisees in the retail motor trades invest significant amounts of capital in their franchised businesses and they therefore require a reasonable period of tenure to recoup that investment. The Code does not however currently contain any provision dealing with the minimum tenure period of franchise agreements. As such, franchisors can offer franchise agreements with tenure periods that are insufficient for franchisees to recoup their investments. In light of the significant investments many franchisees make in their franchised businesses, MTAA considers that this is unacceptable. MTAA therefore believes that the Code should be amended to stipulate a minimum tenure period for franchise agreements. In that regard, MTAA considers that a minimum tenure period of five years would be appropriate for franchising arrangements in the retail motor trades given the very significant investments many retail motor traders (in particular, new car dealers) make in relation to their franchised businesses.

Termination at Will Without Due Cause

As noted above, many franchisees in the retail motor trades invest significant amounts of capital in their franchised businesses. Any decision by a franchisor to terminate the franchise agreement will likely cause the franchisee considerable financial distress. While MTAA accepts that franchisors should be entitled to terminate a franchise agreement in the event of a clear and material breach by the franchisee, the Association considers franchisors should not be able to terminate an agreement at will without due cause.

MTAA considers that agreements which provide for termination at will, without due cause, are harsh and unfair as they result in a situation where the bargaining power in the relationship rests solely with one party – the franchisor. Those agreements also enable franchisors to undertake a restructure or rationalisation of its franchise network by simply terminating the relevant franchise agreements rather than actually having to pay due respect to those agreements by negotiating an acceptable outcome with affected franchisees. In light of that, MTAA considers that the provisions of the Code dealing with termination at will (Clause 22) should be removed from the Code and replaced with a new clause proscribing termination at will, without due cause.

Unilateral Variation of Franchise Agreements

The purpose of disclosure is to provide franchisees with sufficient information to decide whether or not to enter into the business arrangement proposed by the franchisor. It is on the basis of that disclosure that the potential franchisee assesses

the financial rewards and risks associated with the business. The ability of the franchisor to subsequently vary the terms of the agreement in a unilateral manner may therefore result in a circumstance whereby the revised terms of the agreement are materially different to those contained in the original agreements. In such circumstances, it is possible that the franchisee may not have entered into the agreement had the revised terms been included in the original agreement.

While MTAA acknowledges that franchisors may need to amend certain elements of the agreement in response to marketing and trading conditions, the Association is firmly of the view that such changes should only be made after the franchisor has consulted with its franchisees and they have consented to the proposed changes. This approach, in MTAA's view, is necessary to ensure that franchisors do not materially alter the terms of the franchise agreement in a manner which may have a significant detrimental impact on the viability of a franchisee's business. It also ensures that the nature of the business arrangements do not vary materially from that disclosed by the franchisor in its disclosure document (upon which the franchisee made its decision to invest in the business). MTAA also believes that the practice of franchisors changing, through their operating manual and bulletins and without consultation with franchisees, the terms of the dealings between parties should also be proscribed.

Requirement for Parties to Mediate in Good Faith

MTAA also considers that the Code should be amended to include a requirement that any mediation under the Code should be undertaken in good faith and to require that the mediator report to the Office of the Mediation if that has not occurred in a particular case. MTAA considers that in the absence of a requirement to mediate in 'good faith', the mediation process cannot reasonably be expected to deliver either satisfaction with, or confidence in, the alternative dispute resolution process or to provide satisfactory resolutions to disputes under the Code.

MTAA is also concerned that the lack of such a requirement may result in some franchisors simply attending mediation to satisfy the requirements of section 51AC(3) of the *Trade Practices Act 1974* (Cth) (under that section the courts, in determining whether conduct is unconscionable for the purposes of the section, are required to consider whether a supplier has complied with the requirements of any applicable industry code) rather than to resolve the dispute.

Educational Campaign

MTAA notes that a considerable period of time has elapsed since the Code was introduced and that is now a new generation of franchisees and franchisors entering the industry. In light of that, the Association considers that it may be useful if a new Government-sponsored educational campaign was undertaken to advise industry participants of their rights and obligations under the Code.

5. Conclusion

MTAA therefore considers that, while the disclosure provisions of the Franchising Code of Conduct have helped to ensure that franchisees are much more informed than had been the case prior to the introduction of the Code, in respect of matters which may have a material impact on their franchised business, there are some weaknesses in the current disclosure regime. In particular, MTAA believes that the Code needs to be strengthened to ensure that the information contained in disclosure documents is accurate, up-to-date and meets the requirements of the Code.

Franchisors should also be required to provide a copy of their disclosure document to their franchisees on an annual basis. MTAA also considers that the Code should be amended to require disclosure documents to include more detailed information about the risks associated with the insolvency of the franchisor and a change of ownership or control of the franchisor.

In MTAA's view, franchisors should also be required to provide more detailed information about some matters, including the use of certain marketing strategies, the manner in which a franchisee's performance obligations will be determined and any substantial capital expenditure which may be required under the terms of the franchise agreement.

**MTAA
National Secretariat
Canberra**

15 August 2006