MOTOR TRADES ASSOCIATION OF AUSTRALIA

Submission to the Inquiry into the Franchising Code of Conduct

September 2008

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1. INTRODUCTION

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 $160 billion and which employ over 308,000 people. The Association is a federation of the various state and territory motor trades associations, as well as the Service Station Association (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. All of the ATAs 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;
- 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 improve 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 improve the reputation of the trades with its customers and the general public.

1.2 MTAA'S INTEREST IN THE INQUIRY

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, motor cycle 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, has, therefore, 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.

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. NATURE OF THE FRANCHISING INDUSTRY

2.1 MTAA'S HISTORY IN THE DEVELOPMENT OF THE FRANCHISING CODE

Given the character, composition and structure of the businesses that are served by MTAA's membership, franchising issues have been, and continue to be, an area of considerable policy importance to us. The Association has argued in many forums that Governments should avoid the temptation to over-regulate trade and industry and should restrict its involvement to those matters that involve fair competition in the market place.

One of the first steps taken by an Australian Government in acknowledging the interests the Association held in franchising matters, occurred in December 1990, when the then Minster for Small Business and Customs, the Hon. David Beddall MP, invited MTAA to become a principal participating member of the National Task Force on Franchising. This marked the beginning of what would be a long, arduous, and continuing battle to improve the regulation of and conduct in, the franchising sector, with an ultimate goal of creating a fair and equitable environment for all parties.

MTAA continued to be heavily involved in franchising matters throughout the early 1990s, by way of participating in the Task Force on Franchising and then as a member of the Franchising Code Administration Council Ltd. In February 1993 the voluntary Franchising Code of Practice was established. That was the direct result of the culmination of work undertaken by the Franchising Task Force, of which MTAA was the lead and principal member.

A Review of the Franchising Code of Practice was conducted in 1994, with the findings showing that the Code had addressed a number of problems facing franchisees. There were also a number of recommendations made in order to strengthen and improve the Code, a number of which were adopted by the then Labor Government in its Response to the Review.

In 1996 the Coalition Government was elected, and unfortunately many of the initiatives outlined in the Labor Government's response to the Review of the Franchising Code of Practice were not adopted. However, in the Government's response to the 1997 Reid Report into fair trading, it proposed to amend the Trade Practices Act to provide for the mandatory, or voluntary, prescription of industry codes. It was announced that a new franchising code was to be a mandatory code, the enforcement of which was to be the responsibility of the Australian Competition and Consumer Commission (ACCC). The Government also proposed that a Franchising Policy Council (FPC) be established to advise on the development, maintenance and promotion of the franchising code of practice and franchising trends. MTAA welcomed these proposals and considered it a positive step towards more equitable franchising arrangements.

On 19 June 1998, the then Minister for Employment, Workplace Relations and Small Business, the Hon. Peter Reith MP, launched the Franchising Code of Conduct, to be operative from 1 July 1998. While the Code did not contain quite all of the matters MTAA originally asked for, it was indeed a significant improvement on the previous situation and a testament to the efforts of the Association and its Members over a very long period of time.

In 2000, MTAA presented a submission to the review of the Franchising Code of Conduct, in which the Association indicated its strong support for the continuation of a mandatory Code and also made a number of recommendations aimed at strengthening aspects of the Code. In particular the Association argued that the dispute resolution procedures were perceived as 'having no teeth' as there was not any requirement for an outcome to be achieved (only that a process be followed). The Association also recommended that that Code should be amended to remove the ability of franchisors to terminate franchise agreements 'at will' and without just cause.

The then Government, in October 2000, announced its response to the Code review. There were some minor changes to the Code, which were scheduled to take effect from 1 July 2001, including the development of a short form disclosure document for franchisees with turnovers of less than $50,000 per annum. For the larger franchisors, however, the essential elements of the Code remained largely unchanged. The dispute resolution procedures were improved slightly (though not to the extent that MTAA would have wished) with the inclusion of requirements for the persons attending mediation to be authorised to decide on settlements and the inclusion of a 30 day time frame. During this period the FPC was also disestablished.

In 2003 MTAA welcomed the ACCC's decision to establish a Franchising Consultative Panel (FCP). The establishment of the FCP enabled MTAA to revive its matters of concern and present them to a Government agency with the capacity to lead the debate for reform.

In August 2003, Caltex and Woolworths announced that they intended to enter into a joint venture arrangement for fuel retailing, including the expansion of the then current Woolworths Petrol Plus shopper docket to participating Caltex and Ampol sites. In MTAA's view the approach taken by Caltex in relation to its dealings with its franchisees following the announcement of its alliance with Woolworths was less than satisfactory and, many would suggest, less than entirely appropriate. The fact that franchisees were left with no option but to commence legal action, in order to get Caltex to agree to negotiate with the franchisees, in relation to a situation which effectively saw their franchisor establish a competitive retail network, is indicative of why significant reform of the Trade Practices Act is required to address small business concerns about market power and unilateral behaviour.

In June 2006, when the then Government announced a Review into the Disclosure Provisions of the Franchising Code of Conduct (the Code), MTAA, in consultation with Members, prepared a comprehensive submission to the Review. MTAA noted that there were weaknesses with the existing disclosure provisions, which prevented franchisees from being fully informed about the risks associated with the franchises and thus they were unable to develop appropriate risk management strategies for their businesses. MTAA suggested that the Review consider amending the Code to ensure that franchisees were supplied with accurate and up-to-date disclosure documents that included information relating to the financial status of the franchisor, performance obligations, marketing strategies and capital expenditure. MTAA also raised the need for franchisees to be notified of any potential for change of ownership of the franchisor and the subsequent impact upon franchisees, should such a change or other significant material change in the franchisor's situation occur during the duration of a franchise agreement. In that regard, the MTAA proposed that the Code be amended to include a clause that required franchisors to lodge a copy of their general disclosure document with the Australian Competition and Consumer Commission (ACCC) on an annual basis; with a view to having a register of disclosure documents, of which random samples could be audited for compliance. MTAA also sought a strengthening of existing provisions of the Code and the removal of a clause which provided exemption for some franchise arrangements from Code compliance.

On 6 February 2007 the then Government released the Committee's Report on the Review of the Code as well as the Government's Response to the Review. While the Review found that the Code was operating effectively, it made recommendations to ensure that prospective franchisees are in possession of as much information as reasonably possible. The Australian Government accepted a total of 31 of the 34 recommendations outlined in the Committee's Report on the Review. On 15 August 2007, the amendments to the Code were tabled in Parliament by the Government. These amendments came into effect on 1 March 2008. The Government adopted the majority of the recommendations of the Review but unfortunately did not remove, as MTAA had hoped, subclause 5(3)(b), the exemption of some agreements from the Code. However, MTAA believed the amendments, as a whole, were a welcome addition to the Franchising Code of Conduct.

2.2 CURRENT FRANCHISING ENVIRONMENT

MTAA acknowledges that the current franchising environment has been significantly improved following the introduction of the mandatory Franchising Code of Conduct in 1998, for which MTAA advocated extensively. However, the Association believes that the franchising environment, as a whole, still remains weighted significantly in favour of the franchisor in terms of the rights and responsibilities established under the Code. The Association believes that there is a case for a further strengthening of the Franchising Code so that the balance in the power relationship between franchisees and franchisors may be shifted in order to create an environment which is mutually beneficial for both parties.

MTAA is of the view that a more fair and equitable franchising environment can be created through improvements to the Code in a number of areas, including:

- provisions for parties to 'act in good faith'
- stronger and more transparent dispute resolution provisions;
- further disclosure requirements for franchisors;
- provisions to provide for mandated minimum tenure;
- provisions to deal with termination at will without due cause;
- provisions to deal with unilateral variation of franchise agreements; and
- amending the definition of a franchise agreement and the exemption clauses.

3. INCLUSION OF AN OBLIGATION TO 'ACT IN GOOD FAITH'

By its very nature the franchising relationship is quite distinct from any standard commercial relationship and consequently it requires a greater degree of consideration with respect to the 'good faith' in dealings between the parties. As a result of this inter-dependant relationship, the long term success of one party is reliant on the co-operation and performance of the other. For this reason the usual commercial conduct of 'acting at arms length' and the 'pursuit of individual interests' can not be expected or tolerated by the parties to a franchise agreement. Rather, the franchise relationship should be co-operative, enduring and guided by the principle of good faith. MTAA observes that the issue of good faith is a principle that has arisen regularly in recent franchise litigation, and as such is relevant to consider in any review of the Franchising Code of Conduct.

For example, the case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (*Renard Constructions*), centred around the question of whether a construction contract contained an implied term that when exercising a power to take over a site and exclude a contractor, a principal must act reasonably. The court found there was an implied obligation on the principal to act reasonably on the basis that the contract would be ineffectual without such a term. *Renard Constructions* marked the emergence of a judicial position whereby Australian courts recognised an implied duty of good faith in relation to commercial contracts. Since *Renard Constructions,* state and federal jurisdictions have followed suit, and the principle of good faith has been recognised in the specific context of franchise agreements. The case of *Far Horizons Pty Ltd v McDonald's Australia* (*Far Horizons)* expressed that a franchise agreement has an implied term of good faith and fair dealing, obliging the parties to exercise their power under the contract *'in good faith and reasonably, not capriciously or for some extraneous purpose'*. This was further followed in *Bamco Village Pty Limited v Montedeen Pty Limited* (*Bamco Villa*) wherein it was agreed that the duty of good faith is a legal incident of a franchise agreement.

While there is judicial support for a term of good faith and fair dealing to be implied into a franchise agreement, it can be negated by an express term of a contract to the contrary. In this context the lack of bargaining power of an individual franchisee often results in a franchise agreement being entered into in a standard form, and on a 'take it, or leave it' basis.

In *Far Horizons* the plaintiff entered into a licence agreement with the defendant for the running of two McDonald's restaurant franchises. The licence agreement included a clause titled '*Entire Agreement'* which stated that the written licence agreement constituted the entire agreement between the parties, and that "*No obligations of the Licensor shall be implied in addition to the obligations herein expressly provided."*

The existence of such a clause or other clauses, which negate the implied duty to act in good faith in franchise agreements, may allow a franchisor or licensor to contract out of any obligations that are usually implied by contract law; including the implied duty to act in good faith. MTAA submits that due to the bargaining power imbalance, the franchisee, as the more vulnerable party to the agreement, will continue to voluntarily enter into agreements despite the existence of unfavourable terms and clauses. For this reason, legislation should intervene to set the minimum standard of conduct to protect the parties to the franchise agreement. If the concept of good faith was expressly included in the Code, it would prevent franchisors from removing the term and attempting to avoid, by contractual arrangement, such a significant common law protection.

In the absence of statutory clarity regarding the duty of good faith, franchisors are able to argue that express powers such as notice period clauses or the aforementioned 'entire agreement' clause, cannot be subject to an implied term or duty. MTAA submits that the termination of franchise agreements (particularly those that have been long standing) is often a source of conflict amongst parties to the agreement. In *Gary Rogers Motors (Aust) Pty Limited v Subaru (Aust) Pty Limited* (*Rogers Motors*) the term 'good faith' was found to require a party to an agreement to act in good faith '*…not only in the performance of contractual obligations, but also in the exercise of power conferred by the contract'*. Justice Finklestein concluded that there is no reason why this obligation to act in good faith would not act as a restriction on a power to terminate a contract.

While the conduct of the franchisee in *Rogers Motors* was questionable, the court maintained that an implied duty of good faith required the parties to refrain from acting '*capriciously'*. In these circumstances it was found that while the franchisor ultimately had grounds for terminating the agreement, an expedient decision to do so, without affording the dealer any procedural fairness, would be seen to amount to capricious conduct and would be in breach of the doctrine of good faith and fair dealing.

The decision in *Rogers Motors* has ongoing relevance in franchising disputes where the franchisor has unstated motivations for terminating the franchise agreement, but seeks to rely on a minor or isolated contractual breach by the franchisee. MTAA submits that this conduct often occurs where dealership agreements are entered into by the franchisor and dealer on the basis that the agreement will continue indefinitely as long as performance requirements are met. When the franchisor later wishes to terminate these contracts, for reasons not accounted for in the contract, trivial or 'one-off' breaches by the franchisee are relied on as the basis for termination. Similarly, in *Renard Constructions,* it was maintained that contracting parties must not exercise their power based on a lack of relevant information. MTAA believes that if the concept of a duty to act in good faith were to be explicitly included in the Code it could arguably prevent the termination of franchise agreements, where the franchisor is relying on trivial or isolated breaches of the agreement and prohibit the franchisor from using their express contractual powers to negate their duty to act in good faith.

In *Bamco Villa* the termination of the franchise agreement was found to be in breach of the implied duty to act in good faith. In this case the franchisee operated two car rental franchises in Victoria. The franchise agreements contained a clause of 'exclusive rights' regarding the use of the franchise name and trademark in the specified franchise territory. A centralised telephone number was also established to divert calls to the franchisee in the most appropriate geographical areas. Despite these rights the franchisor established, within the territory, a competing car rental business under an alternative trade mark name, which also had the advantage of the centralised telephone number. The

discretion of to whom the calls were diverted was left up to the franchisor. As a result of the establishment of the competing company and the franchisor's preference to divert business to the franchisee's competitor, the franchisee suffered considerable financial difficulty. In this case the Victorian Supreme Court found that conduct by the franchisor of establishing and giving preferential treatment to a competing business was seen to be a breach of the duty of good faith.

In *Overlook v Foxtel* a licensor engaging in acts outside the contract was deemed to be in breach of the implied term of good faith. In this case the licensor engaged in discussions with prospective new dealers for the supply of pay television subscriptions, which, if realised, would ultimately be in competition with the existing dealer. The courts found the licensor's conduct did not give due recognition or regard to the legitimate interests of the party to the original dealer agreement, and the procurement of competing business was unreasonably interfering with the dealer's right to enjoyment of the express contractual terms.

As the concept of good faith has been judicially considered on several occasions, the large body of case law provides examples of conduct and behaviour that assist in specifically defining the term, and the actions that will be seen to breach it. MTAA submits that the express inclusion of the concept of good faith into the Code would be advantageous to both franchisees and franchisors in that a clear benchmark of acceptable conduct would be defined.

Finally, MTAA submits that the explicit inclusion of a good faith requirement into the Code would more closely align the legislation with the policy objectives for which it was established and was originally designed to achieve. When the Code was initially introduced in 1998, the goals of the regulations included *'…addressing the power imbalance between franchisors and franchisees'* and *'…raising the standards of conduct in the franchising sector without endangering the vitality and growth of franchising*'. The subsequent amendments to the Code have attempted to advance it with this view in mind, and it is the MTAA's submission that the explicit inclusion of the term good faith into the legislation would be in continuance of achieving these objectives.

4. INTERACTION OF THE TRADE PRACTICES ACT AND THE CODE

4.1 INTERACTION BETWEEN THE CODE AND PART IVA

Those who protest the explicit inclusion of the concept of good faith into the Code, have tended to argue that the term is difficult to define, and may place additional uncertainty and ambiguity into the already complex franchising relationship. An argument has also been raised that the existence of 'good faith' in section 51AC(4)(k) of the *Trade Practices Act* (TPA) is sufficient to protect parties to a franchise agreement. In response to these arguments, MTAA submits that the case examples mentioned in Section 3 of this Submission are evidence that the concept is clearly recognised amongst the Australian judiciary and the conduct that amounts to a breach of good faith is widely accepted. MTAA also believes that the reference to good faith in 51AC(4)(k) is not sufficient for the requirements under the Code, as the unconscionability provision of the TPA is a difficult benchmark to meet. Often the conduct of franchisors, whilst significantly detrimental to a franchisee, may fall short of the scope of 51AC. Outlined below are three case examples for reprehensible conduct falling short of unconscionable conduct in the motor vehicle dealership trade.

Case 1

Facts: A dealer agreement ("the Dealer Agreement") between a dealer ("the Dealer") and a motor vehicle supplier ("the MVS") was entered into. The Dealer operated under this Agreement for approximately 23 years. The Dealer Agreement did not contain an expiry date but did include a

right for the MVS to terminate the Agreement with 12 months notice. The MVS exercised this right and served a notice of termination on the Dealer.

Issue: While the Dealer Agreement did give the MVS a right to terminate the agreement with 12 months notice, the exercise of this right was unreasonable in the circumstances. It is generally accepted that dealer agreements should not be terminated unless there is a default of the agreement or otherwise non-performance by the dealer, which is not capable of remedy. The Dealer was not in breach of the Agreement and had been successfully operating the dealership for a significant period of time. During the operation of the dealership there had been considerable investment in the business including the construction and improvement of the business sites.

The conduct of the MVS was considered to not reach the standard of unconscionable conduct currently set by the legislation and common law. Given the contractual rights of the MVS, the Dealer had little other recourse to recover the true value of the business and the goodwill which it had developed and thus lost.

Case 2

Facts: Two dealer agreements ("the Dealer Agreements") between a dealer ("the Dealer") and a motor vehicle supplier ("the MVS") were entered into for two separate but adjacent territories ("territory 1" and "territory 2"). The Dealer Agreements were executed on 1 May 2001. Shortly after entering the Agreements the MVS advised the Dealer that the premises for the dealership located at territory 1 were not up to the MVS's standards. The MVS proposed that the Dealer establish new premises in territory 1, however the Dealer considered this option to be economically unfeasible. Alternatively, the MVS proposed to terminate the Dealer Agreement for territory 1 and to conduct business from territory 2 only. The Dealer agreed. The MVS refused to allow the Dealer to assign the dealership for territory 1 and the Dealer was consequently unable to sell the business as a going concern (significantly reducing its value).

From September 2002 the Dealer conducted the business solely from territory 2. In May 2004 the MVS appointed a new dealer to territory 1. On 28 September 2004 the MVS advised the Dealer that its Dealer Agreement for territory 2 would be terminated in 2 years. During the 2 year notice period the MVS supplied the Dealer's customer records to the new dealer appointed in territory 1.

Issue: Despite the complicated chain of events, it is clear that the MVS was regularly and deliberately undermining the business of the Dealer in order to exploit the goodwill developed in both territories. The MVS was not in breach of any contractual obligation; however the overall effect of each of its actions is detrimental to the Dealer. The high standard that is currently applied to unconscionable conduct makes it difficult for Dealers to access the remedies available. There is a reoccurring issue in the motor vehicle dealership trade related to termination or non-renewal of Dealer Agreements. In many of these cases Dealers are limited by the terms of the Dealer Agreement, which are usually drafted in the MVS's favour.

Case 3

Facts: A dealer agreement ("the Dealer Agreement") between a dealer ("the Dealer") and a motor vehicle supplier ("the MVS") was entered into. The Dealer operated under this Agreement for approximately 20 years. The Dealer Agreement had an expiry date of 1 September 2009. The MVS advised the Dealer, 12 months in advance, that it would not be renewing the Agreement on 1 September 2009. When pressed for a reason, the MVS claimed that the reason was the poor performance of the Dealer. The Dealer denied such a claim and no formal breach notice was ever issued.

Issues: While the MVS was under no obligation to renew the Dealer Agreement, there was an expectation based on previous experience and industry standards that the Agreement would be renewed unless there was a breach by the Dealer. The MVS made vague allegations that there had been a breach, but failed to substantiate the breaches or provide written notice of any default as required by the Franchising Code of Conduct. It was later discovered that the MVS had already begun negotiations to appoint another company (which already owned its own dealership) to the premises.

Again, despite the fact that the conduct of the MVS was widely considered to be unfair, the conduct fell short of being unconscionable. While it is acknowledged that the MVS was under no contractual obligation to renew the Dealer Agreement, it was a legitimate expectation that it would be renewed. The Dealer was not in breach of the Agreement (despite any allegations to the contrary) and had it not been for the deal that had been negotiated between the MVS and the third party company, it assumed that a renewal would have been granted.

In addition to the case examples listed above, outlined below are actual clauses from current Motor Vehicle Dealer Agreements. MTAA believes that these objectionable clauses are further evidence of the one sided nature of many motor vehicle dealer franchise agreements. The clauses also highlight the inability of individual franchisees to negotiate changes which reflect an appropriate balance of the risks for each franchisee.

No Right of Renewal

Supplier A may at any time in its absolute discretion give written notice to the Dealer setting out that Supplier A will not renew this agreement or extend the term of this agreement. If Supplier A gives such notice to the Dealer, this agreement will end on the later of the last day of the term of this agreement or the day being 12 months after the date of the notice. Supplier A does not need to give the Dealer reasons for not renewing or extending this agreement

Goodwill

The Dealer acknowledges and agrees that at the end of the Dealership, the Dealer will not receive any payment or compensation from Supplier B for any goodwill in connection with the Dealership or any reputation developed by the Dealer in connection with the Dealership or the Premises.

Right of first refusal

Within 7 Business Days of receiving the notice of intention to sell the Sale interest, or such other time as agreed by the parties, Supplier C has the right to make an offer to purchase the Sale Interest on terms no less favourable to Dealer than the offer set out in the notice, and Dealer is obliged to sell the Sale Interest to Supplier C on those terms.

Prime Market Area (PMA) Non-Exclusive Use

Despite anything expressed or implied to the contrary in this agreement, no exclusive rights are granted to the Franchisee, in respect of the marketing and sale of Supplier D vehicles and Supplier D products and/or the supply of Supplier D services within the PMA.

Termination at will

The Franchisee or Supplier D may terminate the Agreement for any reason without any obligation to pay compensation at any time by giving the other party ninety (90) days written notice.

As the cases and objectionable clauses above demonstrate, there is a clear need to amend the Franchising Code to eliminate this type of behaviour. MTAA submits, therefore, that the explicit term of the duty of parties to act in good faith could be practicably inserted into Part 3 of the Code '*Conditions of the franchise agreement'*. As the concept of good faith is at the crux of the franchise relationship, MTAA believes that the inclusion of the explicit term in this area of the Code is both practical and suitable and would assist franchisees dealing with unconscionable conduct.

4.2 INTERACTION BETWEEN THE CODE AND PART V DIVISION 1

MTAA acknowledges that Part V Division 1 of the *Trade Practices Act* deals primarily with legislation governing consumer protection in dealings with corporations, and thus outlines the conduct that a corporation is prohibited to engage in. MTAA also notes that on 8 May 2008 the Productivity Commission released its final Report on the Review of Australia's Consumer Policy Framework.

The central recommendation of the Productivity Commission's report was the introduction of a single generic consumer law applying across Australia, based on the consumer provisions in the TPA, modified to address gaps in its coverage and scope. Notably, the Report also endorsed a continuation of the thrust of current generic consumer law in regard to the definition of a consumer, meaning that some business transactions would continue to be covered. Therefore, if national consumer legislation were to be established, a number of small business franchisees may be afforded the same protections as individual consumers, providing they meet the small business consumer criteria, which has yet to be drafted.

The Commission also stated that a by-product of the Commission's proposal to create a new national generic consumer law, based largely around the provisions of the TPA, would be an increase in protection and benefits for small businesses, and therefore some franchisees, in jurisdictions where the definition of a consumer is currently more restrictive than in the TPA. The Commissions proposals for the national consumer law include:

- *the introduction of specific provisions covering the use of unfair contract terms;*
- *measures to improve access to redress, including allowing written submissions to tribunals and small claims courts;*
- *giving consumer regulators a wider range of enforcement tools;*
- *changes to improve disclosure requirements; and*
- *more public funding for consumer advocacy and research.*

On August 15 2008, the Ministerial Council for Consumer Affairs agreed that all Australian governments should adopt a new national consumer law based on the Productivity Commission's proposal. This new consumer law would contain all of the key features proposed in the Commission's report and is expected to result in benefits to Australian consumers and businesses of up to $4.5 billion. The Council of Australian Governments (COAG) will consider the consumer policy framework proposals at its meeting in October 2008.

It is evident that if the Government chooses to adopt the Productivity Commission's recommendation to introduce national consumer protection legislation, the implications of such an action could alter consumer protection as it relates to the Franchising Code of Conduct. Many small business franchisees may well be offered many of the same protections afforded to individual consumers under new consumer laws. MTAA therefore reserves its position on the impact of a national consumer protection law until COAG consider the proposal in October and legislation is drafted. However, MTAA does recommend that the Committee consider the Commission's Report, the Ministerial Council's response and the outcome of COAG's upcoming meeting, in its Inquiry into the Franchising Code. MTAA believes that the impact of national consumer legislation that has

the potential to cover small business franchisees may alter the way in which the Franchising Code operates. The Association also submits that any forthcoming legislation, that protects consumers from unfair contracts with businesses, needs to be extended to cover unfair business-to-business contracts particularly with respect to franchise agreements.

5. OPERATION OF DISPUTE RESOLUTION PROVISIONS

5.1 COST OF MEDIATION, DISCLOSURE AND DISPUTE RESOLUTION OUTCOMES

MTAA notes that although 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, the Association considers that they should be advised of the fact that those costs may potentially be quite substantial.

MTAA also notes the disclosure amendments that came into affect on 1 March 2008, which stated that the franchisor must disclose any materially relevant facts (such as certain court proceedings) to the franchisee in writing, within 14 days (rather than 60 days) of becoming aware of it. It is also stated that the existence and content of any undertaking or order under section 87B of the Trade Practices Act is now also a materially relevant fact. The Association warmly welcomed these amendments, which allowed for more timely and relevant disclosure to be provided to franchisees. However, MTAA proposes that further amendments to the disclosure provisions of the Code are required in relation to dispute resolution.

MTAA considers that Clause 19 of the Franchising Code requires amendment, due to the fact that in its current state it does not necessarily provide franchisees the necessary power to obtain disclosure documents without the fear of reprisal. The Association believes that Clause 19 needs to be amended to require franchisors to provide franchisees with a current disclosure document automatically once every 12 months from the commencement of the franchise agreement. This would alleviate the concerns that many franchisees currently have in requesting disclosure documents in writing, as they would no longer have any need to fear disturbing the often delicate franchisee/franchisor relationship. Alternatively, the Association would welcome an amendment that would allow organisations representing franchisees, such as MTAA, to request copies of current disclosure documents from franchisors on behalf of franchisees. This proposal would also lessen the burden on franchisees in requesting disclosure documents and prevent any undue tensions that may arise from a franchisee making such a request at an individual level.

The Association also recommends that the disclosure provisions of the Franchising Code be amended so as to make 'materially relevant facts' inclusive of a franchisor's history of all relevant disputation (under the dispute mechanisms of the Code), and for disclosure of that nature needing to be ongoing. That is to say that any dispute under the dispute mechanisms of the Code needs to be a trigger for the updating of a franchisor's disclosure documentation, which – as a 'materially relevant fact' – would then require the dissemination of those details among the franchisees. The inclusion of dispute resolution proceedings as a materially relevant fact would also allow for prospective franchisees to make a more informed decision on whether to enter into a franchise agreement with a potential franchisor. The Association believes that a requirement for disclosure of this level and extent would also encourage dispute resolution.

Further to the dispute resolution process, MTAA believes that amendments are required so that outcomes must be achieved as a result of mediation and that these outcomes are binding, enforceable and admissible as evidence before the courts. Currently there is no requirement under

the Code for an outcome to be achieved as a result of mediation, only provisions to allow for termination of the dispute resolution if the dispute is not resolved. This can prove to be a significant burden on franchisees that are required to pay for half the cost of mediation and are unable to achieve any sort of outcome. Further to this, should an outcome be achieved as a result of the dispute resolution, there is no requirement for this outcome to be enforceable, binding or permissible as evidence before the courts. The Association believes that the absence of provisions requiring an outcome to be achieved, and for that outcome to be binding, undermines the true intention of the dispute resolution process and recommends that amendments be adopted to rectify this problem.

MTAA would also request that the Committee acknowledge that in instances where mediation proceedings do result in one party giving the other a monetary form of compensation, this does not necessarily mean that satisfactory redress has been achieved. These monetary settlements are offered, in many instances, simply to avoid further litigation. Given the nature of mediation, the franchisor-franchisee business relationship often comes to an end in the period following mediation, and the franchisee is left with very little recourse other than to accept the payment from the franchisor. Consequently, the actual cause of the dispute is never resolved and the franchisee's business is often forced to shut down. This potentially leaves other franchisees vulnerable to similar behaviour from the franchisor involved in the dispute and ultimately the franchisor is never made accountable for its actions. This adds further weight to MTAA's argument that franchisees, franchisors and prospective franchisees be required to act in 'good faith'. The explicit inclusion of this term in the Part 3 of the Code '*Conditions of the franchise agreement'* would prevent many of the scenarios that cause mediation to occur in the first place, thus significantly reducing the number of matters requiring dispute resolution and the problems resulting from that. However, should mediation occur, MTAA submits that the explicit requirement of franchisees and franchisors to act in 'good faith' also needs to be inserted into Part 4 of the Code *'Resolving Disputes'*. This would ensure that both franchisors and franchisees would be required to act in 'good faith' while being involved in dispute resolution proceedings, which would also assist in negating the problems currently associated with mediation under the Code.

5.2 PROSECUTION OF FRANCHISORS

While MTAA acknowledges that there have been a number of franchisors that have been prosecuted for failing to meet their obligations under the Franchising Code, MTAA remains concerned that the ACCC has failed to investigate and prosecute larger, more prominent franchisors that appear to be acting in a manner that is contrary to the spirit of the Code.

As MTAA understands it, the ACCC's website shows that since 2004 the Commission has pursued eleven companies for breaches of the Franchising Code and, at the time of writing, a further two companies are under investigation. MTAA commends the ACCC for taking action to prosecute these franchisors for not meeting their obligations under the Code. However, many of these franchises are relatively small and are not major players in the franchising sector as a whole. The prosecution of these franchisors, while welcomed in principle, in MTAA's view does not prove much of a deterrent to larger franchisors. Many larger franchisors have considerable leverage over their franchisees and often use this to alter the franchise agreement to the detriment of the franchisee without fear of retribution. This is due to the fact that franchisees of large franchises are often apprehensive in raising matters with the ACCC for fear of their franchise agreement being terminated.

MTAA recommends, therefore, that the ACCC continue to prosecute franchisors who refuse to comply with the Franchising Code of Conduct and, in particular, to thoroughly investigate any claims made by franchisees against large franchisors as the problem may be affecting many other franchisees that may be fearful of raising similar concerns.

6. OTHER RELATED MATTERS

6.1 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 believes, therefore, that the Code needs to be amended to stipulate a minimum tenure period for franchise agreements. In that regard, MTAA considers that a minimum tenure period of at least five years needs to be provided 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. Where franchisees have met the terms of their agreement then MTAA believes that franchisees should generally expect that agreement to be renewed at the end of its tenure period.

6.2 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 ought to be entitled to terminate a franchise agreement in the event of a clear and material breach by the franchisee, the Association considers franchisors must 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) needs to be removed from the Code and replaced with a new clause proscribing termination at will, without due cause.

MTAA also endorses recent statements made in the Main Committee of the House of Representatives on 1 September 2008, in relation to franchising. The Member for Canning, Mr Don Randall MP, put forward a Motion that requested that the House recognise, and take measures to rectify, the difficulties currently facing franchisees. A number of supporting statements were also put forward from other MPs, including a statement from the Member for Hasluck, Ms Sharryn Jackson MP, who recommended '*…an amendment to the franchising code to require franchisors to explicitly specify, in their disclosure documents, what end of agreement arrangements are in place under the franchise and also to indicate what the franchisee's entitlements are in respect of those'*. The Member for Hasluck also stated that the end-of agreement recommendation came from a recent Western Australian government inquiry into franchising, from which a report was released in April 2008. Ms Jackson also noted that the South Australian Government conducted a franchising inquiry and recommended that the Committee take the reports from these inquiries into consideration in the Inquiry into the Franchising Code of Conduct.

MTAA supports Ms Jackson's statement and also recommends the inclusion of provisions within the Code to allow for an automatic renewal of a franchise agreement, unless there has been a breach of the Code or both parties agree not to renew the agreement. The current short duration of many

franchise agreements are not reflective of the investments and risks taken by franchisees in establishing their businesses. Within the retail motor trade it has been, in the past, the practice to renew franchise agreements unless a breach or non-compliance occurred. Increasingly, however, franchisors are putting profit margins before trade best practice and the franchisee is suffering as a result. It is for this reason that MTAA believes that amendments to the Code are required in relation to the end-of-agreement arrangements and the termination at will clause to better protect franchisees.

6.3 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 that 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 manuals and bulletins and without consultation with franchisees, the terms of the dealings between parties should also be proscribed.

6.4 DEFINITION OF FRANCHISE AGREEMENT AND EXEMPTION CLAUSES

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)(b) of the Code, which exempts some franchise agreements from coverage under the Code. Under that subclause, an agreement that 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.

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 may hold multiple franchises. The Association is concerned 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. This clause also allows for a situation where two separate franchisees can have franchise agreements with the same franchisor, yet due to requirements of turnover imposed by the Code one franchisee may be covered by the Code while the other franchisee may not be. MTAA believes that such an outcome is unacceptable and unjustified. The Association considers that all agreements that 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.

7. CONCLUSIONS AND RECOMMENDATIONS

MTAA has a long history of involvement in franchising, which dates back to the establishment of the Association 20 years ago. This extensive involvement has given the Association a wealth of knowledge on franchising matters and indeed, a unique position from which to pass comment. Although the franchising sector has improved significantly over the past two decades, the Association believes that there is still much that can be done to improve the operation of franchise arrangements through the Franchising Code of Conduct. It is for these reasons that MTAA requests that the Committee carefully consider this submission and the recommendations listed below.

MTAA **recommends** to the Committee that:

1. there is a case for a further strengthening of the Franchising Code so that the balance in the power relationship between franchisees and franchisors may be shifted in order to create an environment which is mutually beneficial for both parties;

2. the express inclusion of the concept of good faith into Part 3 and Part 4 of the Code would be advantageous to both franchisees and franchisors, in that it would more closely align the Code with the policy objectives for which it was established and designed to achieve as well as set a clear benchmark of acceptable conduct;

3. the reference to good faith in 51AC(4)(k) is not sufficient for the requirements under the Code, as the unconscionability provision of the TPA is a difficult benchmark to meet with the reprehensible conduct of franchisors often falling short of the scope of 51AC;

4. the Committee consider the recommendations of the Productivity Commission's Report on the Review of Australia's Consumer Policy Framework and acknowledge that any forthcoming legislation that protects consumers from unfair contracts with businesses, needs to be extended to cover unfair business-to-business contracts, particularly with respect to franchise agreements;

5. Clause 19 of the Code needs to be amended to require franchisors to provide franchisees with a current disclosure document automatically once every 12 months from the commencement of the franchise agreement or alternatively, allow organisations representing

franchisees, such as MTAA, to request copies of current disclosure documents from franchisors on behalf of franchisees;

6. the disclosure provisions of the Franchising Code be amended so as to make 'materially relevant facts' inclusive of a franchisor's history of all relevant disputation (under the dispute mechanisms of the Code), and for disclosure of maters of that nature needing to be ongoing;

7. amendments to the Code are required so that outcomes must be achieved as a result of mediation and that these outcomes are binding, enforceable and admissible as evidence before the courts;

8. the Committee acknowledge that in instances where mediation proceedings do result in one party giving the other a monetary form of compensation, this does not necessarily mean that satisfactory redress has been achieved;

9. the ACCC continue to prosecute franchisors who refuse to comply with the Franchising Code of Conduct and, in particular, to thoroughly investigate any claims made by franchisees against large franchisors as the problem may be affecting many other franchisees that may be fearful of raising similar concerns;

10. the Code needs to be amended to stipulate a minimum tenure period for franchise agreements, with a minimum tenure period of at least five years for franchising arrangements in the retail motor trades;

11. the provisions of the Code dealing with termination at will (Clause 22) needs to be removed from the Code and replaced with a new clause proscribing termination at will, without due cause;

12. an amendment to the franchising code that requires franchisors to explicitly specify, in their disclosure documents, what end of agreement arrangements are in place under the franchise and also to indicate what the franchisee's entitlements are in respect of those;

13. there be an inclusion of provisions within the Code to allow for an automatic renewal of a franchise agreement, unless there has been a breach of the Code or both parties agree not to renew the agreement;

14. the Code include provisions to ensure franchisors do not materially alter the terms of the franchise agreement in a manner that may have a significant detrimental impact on the viability of a franchisee's business; and

15. Subclause 5(3)(b) be removed from the Code so as to ensure all franchise agreements are covered by 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.

MTAA
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Canberra

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