ECONOMICS AND INDUSTRY STANDING COMMITTEE

FRANCHISING BILL 2010

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 11 APRIL 2011

SESSION FOUR

Members

Dr M.D. Nahan (Chairman)
Mr W.J. Johnston (Deputy Chairman)
Mr I.C. Blayney
Ms A.R. Mitchell
Mr M.P. Murray
Mr P. Abetz (Co-opted member)

Hearing commenced at 3.18 pm

LINDSAY, MR MARK ANDREW
Chief Executive Officer, Quick Service Restaurants Holdings Pty Ltd, examined:

DINGLI, MR BRETT CHARLES
In-house legal counsel/company secretary, Quick Service Restaurants Holdings Pty Ltd, examined:

The CHAIRMAN: Thanks for your appearance before the committee today. This committee hearing is a proceeding of Parliament and warrants the same respect that proceedings in the house itself demand. Even though you are not required to give evidence on oath, any deliberate misleading of the committee may be regarded as a contempt of Parliament. Before we commence, there are a number of procedural questions I need you to answer. Have you completed the "Details of Witness" form?

The Witnesses: Yes.

The CHAIRMAN: Did you understand the notes at the bottom of the form?

The Witnesses: Yes.

The CHAIRMAN: Did you receive and read the "Information for Witnesses" briefing sheet regarding giving evidence before parliamentary committees?

The Witnesses: Yes.

The CHAIRMAN: Do you have any questions relating to your appearance before the committee today?

The Witnesses: No.

The CHAIRMAN: The committee received your submission. Thank you for your contribution. Do you wish to propose any amendments to your submission before we get going?

Mr Dingli: The only comment I will make is that I submitted a further letter on Friday which I hope the committee has got because I will be referring to that in our submissions.

The CHAIRMAN: Before we begin asking questions, do you wish to make a brief opening statement relating to the terms of reference?

Mr Lindsay: Yes please.

The CHAIRMAN: If you could describe your firm also.

[3.20 pm]

Mr Lindsay: I would like to thank the committee for the opportunity to address you today with our concerns about the proposed Franchising Bill 2010. We are here to answer any questions that members may have in respect of our submission against the introduction of the bill. I would like to introduce Mr Brett Dingli, who is our QSR internal legal counsel. Mr Dingli will speak to specific legal matters and concerns around the proposed bill shortly. The QSR group operates more than 600 restaurants throughout Australia and internationally, through the combination of both company and franchise operations across three brands—Red Rooster, Chicken Treat and Oporto. We are the only Australian owned, operated and developed franchisor operating in the major QSR fast food chain space against the likes of international brands such as McDonald's, KFC, Hungry Jacks and Subway. Seventy-six per cent of our network is franchised to approximately 235 individual

franchisees. Franchising is not a one-size-fits-all system; franchising is a form of business organisation in which a company that already has a successful product or service, being the franchisor, enters into a limited term contractual relationship with other businesses or individuals operating under the franchisor's trading name and with the franchisor's guidance and direction in exchange for a fee. By its nature, franchising is a relationship between two parties and, as is the case with many relationships, there are going to be disagreements. The extent and often the type of these disagreements depends upon the individuals involved. Franchising is not a guarantee to make money, but it is a business model that is based upon an already successful format. The likelihood of success is improved through the existing, tested business format, including systems and procedures, marketing and supply chain arrangements already developed by the franchisor. Both the franchisor and the franchisee have a choice before they commence their business relationship; the use of pre-disclosure documents is an effective mechanism to ensure both parties take responsibility for their actions towards each other. The existing federal legislation provided through the franchise code of conduct requires a 14-day cooling-off period before a prospective franchisee can commit to the franchise. This legislation already provides more than adequate protection for both parties to ensure each has made sufficient inquiries and investigations on the other before committing to a contractual relationship. There is already sufficient remedy if you subsequently prove that the strict time frames for disclosure, documentation exchange, and/or representations made were subsequently found to be incorrect. The existing legislation already places significant contractual obligation upon the franchisor and the franchisee. I have a selection of documents that we must admit to a franchisee before they can even enter into a franchise within a system. There is a disclosure document, a franchise agreement, a licence agreement and lease documents. You can imagine the extent and complexity of these documents that each party must go through. For a franchisee to change the material terms of franchise agreement requires the franchisor to reissue the disclosure document, and such cannot be retrospective to existing franchise agreements; it is simply not in the interest of franchisors to continually change terms and conditions at will. This would create a significant level of additional administration workload within the organisation. A franchisor is selling a product, so if the terms of that product become onerous, the model will become non-competitive to other systems. There is simply not an endless pool of suitable and financially capable people out there in the marketplace to tap into. The ability of prospective franchisees to obtain funding from banks at the moment also limits the availability of franchisees, as financiers are requiring greater equity in their loan ratios. Franchisor systems have to remain competitive, just like other forms of business. In my eight years involved in franchising through our group, we have only ever had four major disputes with franchisees, three of which have been resolved through mediation processes, and one that remains unresolved. I define "major" as a material disagreement around representation or documentation, not a disagreement involving invoices or the fact that the franchisee did not like a marketing campaign. In my experience, franchisee issues will have the highest probability of occurring within the first two years of the relationship, which is always the toughest period for any new business, as has been established. We have yet to ever have an end-of-term dispute. End-of-term disputes are generally not in the interests of franchisors, as there is already a shortage of suitable franchisee candidates to take on these systems. The likelihood of a franchisor not renewing a franchise agreement at the end of a term would only occur, in my view, if there had been sufficient evidence and communication by the franchisor to the franchisee around compliance with the system and the standards. The overall value of the brand and its appeal to an individual or business is enhanced when there is total compliance with the systems and standards, which makes all franchisees' businesses worth more. If you have a great franchisee who is doing everything right, why would you not want to renew their franchise agreement at the end of the term? Their success is your success. In circumstances where a franchisor may enter into an agreement to take back a franchise, in the limited situations in which this has occurred in our group, the franchisor reinvests into the business to bring it back into the current standard in order to be able to onsell it to a new franchisee at cost. The cost to the franchisor may also include the repayment of

supply chain debts, if the franchisee has got into financial difficulties, simply to ensure and maintain a relationship with that supplier. There have been many references to rogue franchisors, but as yet no-one has provided examples of those systems, so I cannot comment about who or what they may be. It has also been assumed by many that franchisors do not have mortgages, marriages or relationships; I can assure you that this is not the case, and that franchisors feel every bit of the stress of running a business as everyone else. Franchisees have a responsibility just as much as franchisors for the success or failure of the system. Franchising is a business, and the decision to enter into a franchise is the same as a prospective franchisee going into business for themselves. Each has a degree of risk; it is expected that in franchising, particularly through well-established and well-run systems, that that degree of risk will be less, but financial performance is still not guaranteed, even in franchising.

We have four key concerns with the proposed legislation as it is currently presented. They are: extraterritoriality; definition of "good faith"; the impact and use of redress orders; and mediation provisions. I will now hand over to Mr Dingli, who will go through each of these points in more detail. Thank you.

Mr Dingli: Before I talk about those four points, I just want to talk about uniformity of legislation in Australia. I guess our concern is that by creating state-based legislation, we are used to uniformity across the board, and that is particularly a concern to us as a national franchisor. These sentiments are actually echoed in an earlier —

The CHAIRMAN: Just to clarify, you are based in Balcatta, but you have a national footprint?

Mr Dingli: Yes, that is right. We have state offices in Queensland, Victoria and New South Wales.

The CHAIRMAN: What portion of your outlets are in WA as opposed to the rest of Australia?

Mr Lindsay: Today we would have approximately around 30 per cent here in Western Australia.

Mr Dingli: In relation to the issue of uniformity, these sentiments were echoed in an earlier independent state inquiry into the operations of franchise businesses in Western Australia, which was released in 2008. The WA inquiry found that the regulatory change to the franchising sector should be undertaken by the commonwealth government, given that franchising often involves national brands operating across Australia. The Western Australian inquiry noted that there is an opportunity for the Western Australian government to provide national leadership and direction to the commonwealth government by requesting that it implement all the recommendations of the inquiry.

[3.30 pm]

In a letter to the federal franchising inquiry dated 18 July 2008, the then Minister for Small Business, Margaret Quirk, stated —

> The WA Inquiry concluded that, while existing legislative provisions serve the franchising sector adequately, there is scope for improvement to be made to the disclosure provisions of the Franchising Code of Conduct … its monitoring and enforcement, and its overall understanding, particularly by prospective franchisees. Importantly, the WA Inquiry did not recommend separate State legislation, but rather, regulatory changes to the sector should be undertaken by the Commonwealth Government given that franchising often involves national brands operating across Australia.

So here we have, about three years ago, a view by the then state government that the matter should be handled by the federal government and there should be uniformity. There may be things that we might like to change, but they should be referred to the federal government. At the time, they suggested that WA could take a leading role in this. We will find out later that they actually did.

Turning to the four points that Mark talked about in relation to our concerns regarding the Franchising Bill, what I intend to do is just briefly talk about these and then I will take questions in

relation to them. As Mark mentioned, we have got four major concerns with the provisions of the Franchising Bill. These relate to the extraterritorial effect within provisions of the bill, the definition of good faith, the ability to extend the franchise agreement following its expiry utilising redress orders, and the failure to include provisions enabling the parties to mediate.

I will talk briefly about the first one, which is extraterritoriality. Our concern is that in light of the definition of a WA franchise agreement in the bill, the bill may apply to all our group's franchise agreements, whether they relate to stores in Western Australia or other states. This is because a WA franchise agreement is defined in clause 4 of the bill to be an agreement that "relates to the conduct of a business". It does not refer to a franchisee's business or a franchisor's business; it refers to "a business in, or partly in, Western Australia". Since QSRH carries on a business in, or partly in, Western Australia, our concern is that all our franchise agreements may be caught by the bill.

Mr W.J. JOHNSTON: Sorry, can I just ask you about that?

Mr Dingli: Yes, sure.

Mr W.J. JOHNSTON: The letter you have tabled from Peter Quinlan, SC, actually concludes the opposite.

Mr Dingli: Well, I am going to talk about that a little bit later, and the answer is that, no, it does not. I agree with you to the extent that he suggests one way or the other, that is certainly true, but he actually qualifies that advice.

Mr W.J. JOHNSTON: Yes, I know, I have got it in front of me right now.

Mr Dingli: I am happy to talk about that.

Mr W.J. JOHNSTON: Do you want to come to that?

Mr Dingli: Yes, that is fine; not a problem. So if we talk about extraterritoriality, you are quite right that we have obtained legal advice. We have obtained legal advice from our solicitors, Norton Rose, as well. Initially, we got advice from Norton Rose. Norton Rose advised us to the effect that if a franchisor conducts its business in Western Australia, the act will apply to all our franchise agreements, regardless of whether or not those businesses are located in WA. Obviously subsequent to that, we considered that this was extremely important to our business, so we actually sought specific advice from Peter Quinlan, SC, as you pointed out. You have got a copy of that advice. Briefly, the advice we have received is as follows, and I simply summarise that. He says that it is clear from section 6 of the act that there is an intention to apply the franchising act extraterritorially. Indeed, section 6 is headed "Extra-territorial application". However, this is qualified, he says, by the definition of what a WA franchise agreement is. Briefly, as I mentioned before, a WA franchise agreement is defined in section 4 of the act to mean a franchise agreement that "relates to the conduct of a business in, or partly in, Western Australia". Counsel considers there are two actual alternative interpretations of that definition. I think it is important to understand that. Certainly, the conclusion that you have mentioned is right, but he does say that there are actually two alternatives. He says based on a wider interpretation, a reference to business can include the business of a franchisor—that is, our business as such. Based on this wider view, if that were accepted, all our franchise agreements would be caught by the act, irrespective of which state they relate to. He then goes on to say the narrow view is that the reference to a business in the definition means the business to the franchisee. You are quite right, he concludes that whilst not beyond doubt—so, whilst not beyond doubt, there is still some doubt—a court is more likely to construe the word 'business" in a narrow sense. Accordingly, if a court interprets the legislation that way, then the bill is unlikely to apply to all our group's franchise agreements. Senior Counsel does however stress, and I think this is important, that even on this construction, much depends upon the terms of each individual agreement and on the precise nature of the business carried on by the franchisee. He then gives an example that I think is very important. He says, for example, if a particular franchisee operates a number of stores, whether they are located within and outside of Western Australia, it is

possible that the bill will apply to all of them, irrespective of the location, on the basis that the franchisee conducts a single business, albeit in different locations. Senior Counsel considers that in those circumstances, each franchise agreement, whether or not it relates to a store in Western Australia, could be caught by the provisions of the act. So whilst we have got some advice now to suggest that the narrow interpretation is likely, there are still some issues here. Obviously, I have had the benefit of also reading the submissions by other parties, and this issue that Peter Quinlan has raised has not actually been addressed by other Senior Counsel or QCs, so I think that is quite important.

Mr P. ABETZ: Clause 3(1) of the bill says —

> If a term is given a meaning in the Franchising Code of Conduct (WA), it has the same meaning in this Act, unless the contrary intention appears.

When the bill was being drafted by parliamentary counsel, I actually raised that issue about the conduct of "a business", because I thought it should perhaps be a "franchise business". I was told by parliamentary counsel that it was not needed because under the Franchising Code of Conduct, the term "business" is used exclusively for "franchise business" and is never used as meaning "franchisor". Therefore, given clause 3(1), it would seem to me then that this is actually not an issue.

Mr Dingli: That may well be the case, but I think the fact that because Senior Counsel has raised it as a potential issue—you are referring to references to other parts—it is important, if you are looking at that point, to actually distinguish and stipulate to make it perfectly clear, so that there is unequivocal —

Mr P. ABETZ: That could easily be done.

Mr Dingli: It could, absolutely—I accept that completely.

The CHAIRMAN: Do you want to go through?

Mr Dingli: Yes, thanks for that. That was quite a relevant point you raised, so it was no problem at all.

If I turn to obligations of good faith, clause 11 of the bill requires every party to act in good faith under the agreement. Obviously, we all know that the expression "act in good faith" is defined to mean "to act fairly, honestly, reasonably and cooperatively". This definition extends well beyond notions of honesty and integrity and imposes additional obligations to act reasonably and cooperatively. It actually ignores an existing and different duty of good faith and fair dealing already implied in franchise agreements in Australian common law. We believe the definition will have significant and unintended consequences. I will give you some practical examples that we can think of. If a franchisor decides to divert marketing funds to a particular region, say—they decided to divert marketing funds in the north of the state, for example—could a franchisee in a metropolitan area argue that this was acting unreasonably? I simply do not know the answer to that question.

The CHAIRMAN: We do it in Parliament all the time with the Nats!

Mr Dingli: The other thing as well is our concern is the commerciality of a specific agreement could also be called into question if the franchisee considers it to be unreasonable. For example, with a marketing fund, if we impose a percentage of gross revenue, say, five per cent, could it subsequently be argued by a franchisee that that is actually unreasonable? I do not know. Potentially it could be. I think the answer is that it potentially opens up a Pandora's box, and I think the reason that is the case is that reasonableness is actually very subjective. What one person considers to be reasonable is not necessarily what another person considers reasonable. As a consequence, obviously both the franchisor and franchisee of WA franchise agreements have diverging opinions on what is reasonable in the circumstances because both parties have different objectives and

interests. Ultimately, given the inherent uncertainty the new definition will bring, we anticipate this will open the floodgates to litigation. As a consequence, we anticipate the franchisors and the financiers will reassess the risk profile of franchise systems in WA and financiers may be reluctant to lend money to support WA-based franchise business systems because of the risk.

In relation to renewal orders, which obviously are under clause 14, clause 14 gives a court considerable and far-reaching powers of renewal and may require parties to enter into a new WA franchise agreement, irrespective of whether not there is a contractual right to do so. This could force a franchisor or a franchisee to continue a relationship which has long since deteriorated, despite the fact that the franchise term has expired. This could lead to deterioration of brand equity of both the franchisor and other compliant franchisees, particularly if the outgoing franchisee does not maintain their image to a current or appropriate standard. Obviously if they do not, that affects the rest of the brand and indeed affects other franchisees as well, yet here we could have the effect of having to, in effect, extend by way of renewal that person's franchise, even though it may not be in the best interest of all the franchisees. It also strikes at the heart of what a franchise agreement is all about—a conditional agreement for a limited period of time.

The last point that I briefly wanted to touch about was the issue of mediation. Our concern is that, unlike its proposed South Australian counterpart, this bill does not contain any provisions whatsoever requiring parties to mediate a dispute that actually arises under the bill. This means that an aggrieved party will not have any alternative other than to litigate if they consider there is a possible breach of the provisions of the bill. That is an expensive and ineffective way of dealing with franchise disputes and can only further the notion that the bill will open the floodgates to litigation. I would say that it is our experience as a brand. As Mark mentioned, we have had four instances where we have gone to mediation and we actually have found it is a very, very effective means of resolving disputes and disputes that may have been around for some considerable period of time. It gets the parties to meet together and they meet on equal terms; it is not as though the franchisor has a power base and the franchisee does not. At the end of the day, they meet on equal terms, it gives the franchisee the opportunity to air their grievances and it can be quite a cathartic experience as well. Often there is a lot of emotion that is attached to these sorts of issues and it gives the franchisee the opportunity to voice their concerns and their frustrations et cetera, and it helps both parties, I think, to meet to come to some mutual agreement.

The CHAIRMAN: What office or mechanism did you go to —

Mr Dingli: We have used both the office of the mediator, so the federal, yes, and we found that extremely effective. That was one of the ones that was resolved. I have got to say that a lot of that does depend upon the quality of the mediator that you get, but generally speaking the mediators are very, very good there. Certainly, the one we had in that particular instance was excellent. We have also done it privately where the parties have agreed to mediation and the parties have agreed to appoint a specific mediator. That also has its advantages insofar as you are getting someone who you know is obviously quality and you are choosing them because you consider that they will be the best person for the job.

The CHAIRMAN: Do you put those in your contracts—that is, if there is a dispute of a certain nature, that we go to mediation—or do you just —

Mr Dingli: Yes, we do.

The CHAIRMAN: — rely on the code of conduct?

Mr Dingli: No, we have both, so we rely on the code of conduct and it is also in our franchising agreement as well. We consider that the first port of call if there is a dispute, in fact. As a matter of course, I would always encourage franchisees if they have a dispute to mediate it. It is a chance for us to get together, sit over a table and sort it all out.

The CHAIRMAN: What is the cost of mediation?

Mr Dingli: Very cheap. The cost of mediation is extremely cheap. The cost of the mediator I think —

Mr Lindsay: The last one that we did was $2 500.

Mr Dingli: Yes.

The CHAIRMAN: Between the two of you, the two parties or the —

Mr Dingli: We actually agreed to pay it up-front.

Mr Lindsay: We paid their costs.

Mr Dingli: We decided to pay their costs.

Mr W.J. JOHNSTON: Your submission is that in your view the bill sets aside the current mediation procedures—is that what you are saying?

Mr Dingli: My view is that it does not set it aside, but what it does not do is it does not create mediation provisions for disputes under the bill. That is what I am really saying at the end of the day.

Mr W.J. JOHNSTON: So if the Parliament was minded to continue on the process, you would say we need to have a specific mediation provision in here —

Mr Dingli: Absolutely.

Mr W.J. JOHNSTON: And that mediation could include a specific reference back to the existing mediators?

[3.45 pm]

Mr Dingli: Absolutely; that would be perfect. There is no need to replicate it in here as such, that is for sure. I just have concerns that if our position is right, and this will lead to litigation, there is one path only; there are no alternative paths along the road. That is a real concern for the franchising community in Western Australia.

The CHAIRMAN: Let us say the extraterritorial is an issue. What is the issue there? Let us say some of your franchisees in Queensland might be called before a court here, or to adjudication in Western Australia. What are the implications of that for you and for the state?

Mr Dingli: Good question. What that creates is difficult compliance regimes for our business, because all of a sudden we have got to consider different compliance regimes for particular franchisees as opposed to the rest of our franchisees. So we have to, in effect, probably view it differently, I would have thought. That is our concern as such. The other thing I would say as well is that is not a concern potentially of other competitors of ours. The reason I say that is because we are based in Western Australia. So it creates a disadvantage to our particular business potentially, purely because we are located in Western Australia.

Mr Lindsay: We would also—I am talking here about our industry, not other franchise systems—be at a disadvantage to our other competitors who have significantly fewer franchisees based here in Western Australia alone. They may see the legislation as minor in their mind and not be concerned about it, whereas we have a high number of franchisees both here in Western Australia and on the east coast. That is why we believe it would put us at a disadvantage to our competitors.

The CHAIRMAN: Let us go to the questions now. Thank you for your opening statement.

Mr Dingli: You are welcome.

The CHAIRMAN: The reason we are here, I suppose—the motivation—is that there is a concern, mainly by the franchisees, that there is a series of rogue franchisors—to use the term that has been widely used—who are exploiting their market power or negotiating power by the contract and are

operating outside the terms of the contract. Is that the case in your industry? I am not saying that you would do that! I do not think you would agree with that!

Mr Lindsay: In my personal opinion, I do not believe that to be the case at all. I think that given the nature of our industry and the types of people who operate it, they are very compliant with the franchise code of conduct and the agreements that they have in place. Eight years ago, we did not have a legal department. We did not see it as necessary. Today, I have two in-house lawyers, and we use an external department —

Mr Dingli: And it is growing all the time!

The CHAIRMAN: You are going to lose your job to him!

Mr Lindsay: I would be in trouble if I did not have him, I can assure you! I think that is an example of where this is all going and the problems that we have. In our situation, we have to not only contend with the legislation of this state if it starts to be different from that of another state, but also we have to worry about EHO-related issues and occupational health and safety. There is a plethora of compliance that our industry goes through. In terms of exploiting individual franchisees, I can put my hand on my heart and tell you from QSR's perspective that certainly consciously we have never, never been in that situation. We do satisfaction surveys of our franchisees ever year to find out how they are feeling. Every year in the satisfaction survey the question of financial performance, "Are you happy with it?", always ends up being the smallest part. But the question of optimism and "Are you happy with the system?" is always off the Richter scale. So franchisees by their very nature, I suppose, always consider the returns to be less than what they would hope. However, the situation is that they continue, and our business continues to grow, and we are trying to attract more and more franchisees.

The difficulty that we have with our system right now is that I can get franchisees, but I cannot get them funded. I can give you an example. In the last two months, we have lost four franchising deals because the banks have just decided to stop lending. There is no rational, sane reason behind that. We have very strong relationships with our financiers, and last year we made a couple of phone calls, and a lot of it comes down to misunderstanding, but it has become tighter and tighter. We are extremely conscious of our legal obligations and our support structure. We have advisory councils where we engage franchisees in all our brands to have voice and a mechanism to be able to speak up and to contribute to the process. We certainly have a significant volume of legal documentation. I can assure you I have to sign every one of those, and when they are piled up that high on my desk, I spend the weekend signing away. That is why I need this team to make sure that I understand what is going on in the process. We have got a very, I think, systematic approach be able to do that. If I then get into a situation where we have different legislation to try to deal with those things, I then have to make sure that I am across that and why that is different

Mr Dingli: Can I add to that just for a second? As a result of the last federal inquiry, the federal government did a couple of things to address those sorts of issues. One of the things that they did was they introduced a public warning power to name and shame unscrupulous franchisors.

The CHAIRMAN: Where did they put that?

Mr Dingli: I believe it is in the Australian Consumer Law, so it is not actually in the Franchising Code of Conduct. I am not aware whether that has been utilised yet, but it is certainly there. The idea was to address those sorts of issues. The other thing that we have all been made aware of is that there are new random audit powers for the ACCC to ensure Franchising Code of Conduct compliance. The idea behind why that was implemented was to relieve franchisees from the fear of retaliation by big franchisors. Once again, I am not aware that the ACCC has used this power yet. But it is certainly there, that is for sure. If you are conducting a viable business, the last thing you want is for your business to be named and shamed, basically. That does not serve any purpose whatsoever.

The CHAIRMAN: We saw that with McDonald's in London.

Mr Dingli: Yes. It just does not serve my purpose whatsoever, because what is going to end up happening is that the pool of franchisees that you may attract is going to suddenly get even smaller.

Mr Lindsay: As you are aware, the number of franchise systems is growing daily. There are literally thousands in the system. Therefore, as I said earlier, we are a product that has to compete with other products in the system in order to attract people, and there is simply not that availability of people all over the place who want to come in. At the same time, you have to be conscious of who those people are who you are inviting into your system. We go through quite a rigorous process of doing assessment and evaluation. We have training and development processes that we need to ensure that we have in play for franchisees. I think that is the big difference between major franchise systems and a lot of the start-up systems that are out there. We have spent years on doing that. All of our brands in our group have been in existence for in excess of 25 years. We have had 25 years of developing our systems, and in developing training and supply chain marketing et cetera. We have substantial systems behind us, and we hope that gives us a better ability to be successful and therefore attract franchisees to our system. But often franchisees are looking for that new thing out there. It is a quality of life for some people, and maybe they do not want to work seven days a week; I do not know. That is the difficulty. We have to be conscious of how complex we are making our system in order to be able to attract people.

Mr W.J. JOHNSTON: I imagine there is a range of sizes and franchise fees in your business. You may not want to tell us, but we had a franchisor the other day who talked about these issues. What would a typical business franchisees turn over, and how many staff would they have?

The CHAIRMAN: How much would they have to invest to come in?

Mr Lindsay: It depends. We have three brands, and they operate at different levels within the system. On average, it is $500 000 that the average franchisee has to find, and it is mostly a bit more by the time they put in working capital, and they have to pay the legals and all the other things, but let us say on average it is $500 000. Then they have to make an adequate return out of that investment going forward. In most situations, the difficulty that individuals have coming through the system is that they have to find equity. Most people will borrow that equity against their house, if they have implied equity in their house. But if they do not have equity, as I say, the banks are just saying no. In the last 18 months in the Red Rooster system, we have moved quite extensively into the franchising system, and about 120 of our corporate stores have come into the franchise system, mainly on the east coast of Australia. During that whole process, we found that the majority of the franchisees came from within our system, rather than new people who came in. So it was easier in that respect, because they were already au fait with the system; they understood it and they were keen for it. New people coming into the system are always looking for a different opportunity, and it is certainly a lot harder. So to nurture and grow your system from within is certainly the best option. But you can only take that so far. So you do have to be out there looking for new people. We are lucky in the sense that we have a somewhat ready pool of franchisees already in existence. But for a person starting up a system and coming into a state for the very first time with one store, they have to find the right person. They would not have the systems and the structure behind them to support them. I think they are the systems that certainly are at risk in terms of the ability of people to go forward, as opposed to the bigger systems. But unfortunately, as I said earlier, it is not a one-size-fits all process here.

Mr W.J. JOHNSTON: The most famous dispute in Western Australia is between Competitive Foods and Yum Foods. It is in the media all the time. I was in Rockingham the other day, and the old KFC store is still closed. I do not know the details of that dispute, but it fundamentally appears to be a dispute between the way that Yum wants to run their business in Western Australia, and their long-serving franchisee. Do you have any comment to make? Are there any lessons that as a parliamentarian I should know when you look at that dispute?

Mr Lindsay: Obviously we are not privy to the full details of why that dispute exists. All I can say, as an example of our situation, is that certainly we have never had an environment where we have not wanted to renew a franchise to a franchisee. We certainly do not have a ready pool of multi-site franchisees of that size to be able to come along and do that. So I think the commercial aspect of that is mostly more at play than the simple fact of it being a renewal issue. That is the best I can contribute to that view. I think there are more commercial facts involved in that than there most probably is the idea of it being just that I need to renew my franchise. I think one of the issues—we have talked about this internally—is that if that situation were to occur with us, you would have to take into consideration other people outside of the system. You have landlords, who if you are suddenly forced to renew an agreement, particularly in our situation, where we are not the property owner, but we have long-term leases in place, if that lease had come to its finality and the courts suddenly force you to renew that arrangement, well, are you then pushing that same responsibility onto a landlord who does not want to be party?

Mr Dingli: That raises a very interesting point, I think. The point that I think you are referring to is: would in some way a redress order actually fix that situation? I guess it is an interesting question, because I am not sure practically that it would. If we forget about the Yum example, because obviously what we are talking about is two very big companies, but if we talk about the average mum and dad franchisees, it is important to understand in relation to redress orders that I do not believe this is going to be the panacea that some people think it will be. The reason I say that is because franchise agreements are always inextricably linked to lease terms and tenure. So generally speaking, at the end of a franchise agreement, the franchisor's lease tenure over that site is also at an end. So while at the end of the day it sounds great to say that there is the possibility of being able to make an order—a court can make an order to extend a franchise agreement beyond its expiry—the practical effect is if the lease expires, the court cannot require a landlord to also extend their lease, because that is a third party, and that has nothing to do with this bill at all.

[4.00 pm]

Indeed, you have a look at the legislation, the Commercial Tenancy (Retail Shops) Agreements Act, which does not allow a lessee to be able to extend a lease ad infinitum. What it provides is a statutory period of five years, and that is all. What you said actually raises a lot of issues, but in practical terms there is this thought in the back of people's minds that redress orders are going to fix this situation. I actually think that, practically, it will not make a difference because what will happen is, if the lease ends there is nothing a court can do.

Mr Lindsay: With respect to mum-and-dad operators, fixing their franchise at the end of term in 15 to 20 years' time is the least of their thoughts today. The majority are worried about what is happening in the first two to three years. That is actually the make-or-break period for the majority of franchisees within a system. If it does not work in that first two to three-year period, then generally they are going to struggle. I think end-of-term issues, in my experience and view, are very minor and would be restricted to larger multi-site operations. We have finished doing one; yes, it is a negotiation—it is a horse trading exercise.

Mr W.J. JOHNSTON: This is a renewal?

Mr Lindsay: Yes, a renewal for a long-term franchisee. Each party got the benefit of what they wanted. Each party is happy and moves on.

Mr W.J. JOHNSTON: I am sorry, I have to go. Do you think that if you are operating a franchise with Chicken Treat or Red Rooster and you are complying with the systems that there would be an expectation that they would be offered a further renewal?

Mr Lindsay: I think in both situations—the franchisor and franchisee—if you are compliant with the system, there is an expectation that both parties would want to proceed. Certainly in our situation that is no different. I think at the end of term everyone has to accept and understand that,

generally speaking, at the end of a 10 or 20-year term there is going to be a financial investment required because that particular store will have to be brought up to the current standard. We are going through that again in our own situation right now. That is a big step for a lot of franchisees and some of them have to make that decision whether they wish to continue, or they might say that time is up. For a lot of them, refurbishing a store is probably more expensive than building a new one.

Mr P. ABETZ: Going back to a mediation question—changing the subject a little—basically the intention of the bill was to bring in penalties for breaches of the code to give it some teeth. I notice that was not one of the things that you listed as a concern. I wanted your comment on whether you were comfortable with that aspect of the bill. The other aspect is, if the franchisor is compliant with the code, is there anything that would need to change in your franchise agreement? The reason I ask the question is that Jim Penman, who has one of the biggest franchises in the country, has put in writing that he would not need to change one word in his franchising agreements because he says he is compliant with the code and this bill does not add anything to the code; he already acts in good faith, so he does not have to do anything different. Could you comment on that?

Mr Dingli: If we take the second point first: we would not have to change anything in our franchise agreement whatsoever. But I do not think that is the issue. The answer to that question is that no one should be saying that they are going to change their franchise agreement, because if they say they are, then they are not in compliance with the Franchising Code of Conduct. I think the bigger question is perhaps whether or not these issues might occur in relation to good faith-type issues, for example, as you have mentioned, and perhaps we can talk about that afterwards. In relation to the second point about civil monetary penalty, you are quite right that we did not raise it in our submission. That said, I believe there are some issues in relation to the penalties. I guess I could point out a couple of things. Our view is that it is unnecessary as the Competition and Consumer Act already provides a sufficient array of remedies that are available to courts, including injunctions, damages and other orders that provide for appropriate compensation. I would add that that allows the franchisee to get compensation. It is not a stick; it is not a penalty. It allows the franchisee, who is the aggrieved party, to get a result, as opposed to having some sort of monetary penalty. The other thing that I point out as well is that the commonwealth government in its response to the most recent parliamentary joint committee indicated that, in its view, provisions which attract criminal liability or civil penalties for breaches should be directed at specific wrongdoings only and should not apply to general behaviour. The concern I have is exactly that, and that raises a really interesting point here. How do you quantify or assess pecuniary penalty based on someone who is not acting reasonably or cooperatively? Yet that is exactly what you are going to do. How does someone determine what a dollar value is? How do you attach a dollar figure to not acting cooperatively? That is a very difficult thing to do. It is one that ultimately only a court is really going to be able to answer.

Mr P. ABETZ: Only a court will be able to bring on the penalty.

Mr Dingli: Yes.

Mr P. ABETZ: So the court, having heard all the issues, would need to make the decision in much the same way, would it not, as somebody who sues for something and the court listens to everything and says it thinks that is a reasonable compensation package or whatever?

Mr Dingli: That is slightly different though, because in that scenario you can assess what a franchisee's or a franchisor's loss is. But here, on the other hand, you cannot quantify a penalty for not behaving reasonably or not acting cooperatively, particularly something like acting cooperatively. How do you attract a penalty for that and how do you assess it? Obviously, the member is quite right and it is determined by the court and by the facts, but that is the concern I have with civil monetary penalties.

The CHAIRMAN: I have a couple of questions. You operate in a more expensive front-end business of half a million dollars at least, on average. That is larger than many franchises. I assume that when you get in there, especially with the documentation, you ensure that all your new franchisees read those documents and have advice to help them understand it. So you have a filtering device, which exceeds that of many franchisees. Would you not say that?

Mr Lindsay: I would agree with your observation, but we are following exactly what the Franchising Code of Conduct requires each party to do anyway.

The CHAIRMAN: So most of the people who are franchisees know what they are getting into?

Mr Lindsay: They should do.

Mr Dingli: In answer to that question, the fact is that the disclosure statement provides a lot of information about exactly what they are getting into. The only difficulty I would say is there is so much now to disclose that it is fairly complicated.

The CHAIRMAN: How much would it cost a franchisee to get legal advice to understand that?

Mr Dingli: That depends.

Mr Lindsay: It depends on the lawyer that you go and see.

The CHAIRMAN: Let us say Brett is moonlighting!

Mr Lindsay: He is pretty expensive, actually.

Mr Dingli: That is a really interesting question, and I would have to frame it in terms of perhaps somewhere between $1 000 for a cursory review, but probably $2 000 to maybe $5 000, so it is quite a significant up-front cost. It could even be more than that. It depends at the end of the day on what the franchisee ultimately wants to look at.

Mr Lindsay: We also encourage them to have accountants review their business plans and things like that. There are additional costs involved in things like that. Again, if a franchisee chooses not to do that—we want them to do that and we are obligated to ensure they have undertaken all those opportunities—and I think sometimes franchisees might see an opportunity and want to rush into it. Just a recent example, we are currently going through a process—we are just about finished—in which we acquired a business and we sat down with franchisees and put all new documentation through the system. We had some franchisees wanting to go, "Don't worry about it!" We said, "No, you are going to go through this process and stick to it and make sure everything is done on time." That puts a lot pressure internally because these were already existing businesses that were about to convert over. We could have quite happily gone, "Don't worry about. We'll follow it up next week or the week after", or what have you. But something will happen down the track, I will guarantee it. In part, it comes down to the ethics of the business, but we are particularly focused around compliance with that because we know the potential penalties and the potential damage it can do if you are named in chambers as someone who has not complied with the system. That is our business.

The CHAIRMAN: If this bill were passed, it would have obligations of good faith and specify those four terms. Would that affect the legislation? An allied question is: one of the arguments behind that good faith and the four conditions is that it makes the franchisees and franchisors more clear what the fundamental operating procedures are for the franchise.

Mr Dingli: I disagree with that comment. I think that is an interesting point you raise, and I was hoping we would talk about good faith and such, because I have some considerable concerns with the definition of good faith. Having read the submissions of other parties, it appears to be uniformly accepted that, at common law, courts are prepared to impose an implied obligation upon parties to act in good faith in franchise agreements. I think you will find, if you look at the opinion provided by Daryl Williams in his advice to Competitive Foods, which is annexed to their submission at

paragraph 20, and by the RTA at paragraph 13, and by Associate Professor Zumbo, they all acknowledge that particular point. It has also been acknowledged by the federal government because in 2010 they introduced a provision which actually states in the Franchising Code of Conduct —

> Nothing in this code limits any obligation imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith.

My question to the committee is: if we already have good faith implied in franchise agreements, why do we need to impose a statutory duty of good faith? Associate Professor Zumbo, who I noticed gave evidence earlier today, considers that the statutory definition of good faith captures the essence of the implied duty of common law. The RTA similarly states that it codifies the commonwealth position. But that is not correct. If you look at common law, it is far more detailed. What I would do is draw your attention to a submission that was made by Emeritus Professor Andrew Terry who, ironically, comes from the same university as Associate Professor Zumbo. In his submission, and also in ours, he refers to a 38-page article that he has drafted, which I have. That article is titled "Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions". It provides an extensive review of current Australian case law applying good faith to franchising agreements. This is interesting, because in his opinion—after he has reviewed all that, and to my knowledge no one has reviewed it to that extent—he says that there is no single definition of good faith; and that judges view the concept differently to take into account the different circumstances of each particular faith. The concern I have is that to try to categorise good faith into four concepts is dangerous, because it does not reflect current case law and it gives emphasis to four concepts at the expense of others. I will give you some "others"; for example, a person acting arbitrarily, capriciously, unconscionably, recklessly or for ulterior purposes. These are all issues that are considering in determining whether or not a party is acting in good faith, yet the definition does not refer to those at all.

The CHAIRMAN: So, in legal discussion, those words would be different than before?

Mr Dingli: That is correct. In my view, we should leave it to the courts to apply notions of good faith having regard to the facts of each case, and we should not try to define it in any precise way. This view is supported by Professor Terry and also the ACCC and the current federal government. I will do a quick quote from Professor Terry, who says that in their opinion a single definition of good faith has the potential to propel a franchising sector into a new era of uncertainty, disputation and litigation with notions of good faith being sought to be applied to an indeterminate range of real and imagined grievances and breaches.

Likewise, I add, the ACCC in its submissions to the last federal inquiry considered a good faith obligation, "may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees and potentially increase disputes and conflicts among franchising participants." This is the ACCC saying this.

[4.15 pm]

The ACCC went on to state, and I will quote this as well from their submission —

> The ACCC's view is that good faith is difficult to define independently or reduce to a rigid rule, and if an obligation to act in good faith were included in the Code, the meaning of good faith would have to be considered separately in each case depending on its particular facts. This may introduce ambiguity and confusion about the rights and responsibilities of franchisors and franchisees, and potentially increase disputes and conflicts amongst franchising participants.

That view was actually consistent with the approach that was taken by the federal government in response to the federal inquiry. During his keynote address to the BRW Franchising Conference last

year, Hon Dr Emerson, who was then the Minister for Small Business, actually summed up the federal government's position as follows. He said —

> After extensive investigation, the Government has concluded that a well-defined good faith obligation is not achievable.
>
> The law on good faith is still evolving and there is not a single definition or an agreed, standard set of behaviours that constitute good faith.
>
> Because of this, the inclusion of a general obligation of good faith in the Franchising Code would increase uncertainty in franchising.
>
> Neither Franchisors nor Franchisees would be certain of the occurrence of a breach.
>
> In fact, Court proceedings would be required to establish whether or not a breach had occurred.

Our difficulty is not with the principle of good faith or indeed with the parties acting honourably in their dealings with each other. Our difficulty is with the inability to define "good faith" clear enough for it to be inserted into a mandatory code of conduct. Can I add just in relation to that, obviously good faith needs to be applied to courts in particular circumstances. That is actually supported by other submissions that have actually been made. For example, Daryl Williams in his submission actually states —

> 22. It is to the meaning of the quoted words that the court will turn to determine what the duty to act in good faith requires in the circumstances of a particular case.
>
> 23. The content of that duty, as reflected in quoted words, will depend upon the facts of the case, including the terms of the particular contract and the parties' legitimate interests.

I guess, in summary what I am really saying is this: there is a misconception that four words will define what "good faith" is. The fact is that good faith at common law is much, much wider than those four words and in any event people are still going to have to go to court to determine exactly whether or not good faith applies. It is not going to change. I guess, what I would conclude in relation to that is simply this: if we have a wide definition of "good faith" in common law in Australia, I think it would be folly to try to introduce something that is actually much narrower in Western Australia.

Mr P. ABETZ: You quoted from Daryl Williams' legal opinion, which I have a copy of here too. He also says that actually this bill in its good faith provision actually fills a gap in the current legislative framework. It was interesting when you read the words "capricious" and all those words, if you look at those words, they all fit in, they can all be slotted under those four words that are in the bill. I appreciate the fact that there may be some situations that those four words perhaps do not cover what we would like to have included in "good faith". Do you see if the bill was changed from "'good faith' means those four things" to "includes those four things", would that address some of your concerns?

Mr Dingli: It would partially address some of those concerns. That is certainly true. My argument with that would be: what is the point if it is already implied at common law in any event? Why are we legislating in relation to good faith if it is already implied in common law?

The CHAIRMAN: One argument put forward was that the courts as it evolves are interpreting, as it did "unconscionable conduct" very narrowly; that is, it is evolving to narrow down and restrict the definition of "good faith" in law. So the argument is that this bill will draw a line in the sand and stop that narrowing. I am just trying to paraphrase somebody else.

Mr Dingli: Look, if that is the case, then what you are suggesting is that potentially then there could be wider litigation, because what you are saying there is that people are going to litigate more because of this definition and I have concerns about that. In any event I guess what I would say to that I believe at the moment the federal system works perfectly insofar as there are remedies for

franchisees in any event in relation to unconscionable conduct, misrepresentation et cetera. These franchisees already have a means of being able to institute proceedings.

Mr P. ABETZ: But they cannot afford it. That is often what we keep coming up against. I am not a lawyer but I am beginning to understand that by codifying the good faith court time does not need to be taken up with the franchisee who is going after the franchisor. At the moment, because it is only common law, his lawyers have to argue to take up court time to demonstrate that this common law notion of good faith actually applies in this particular situation. If you look at the case of Justice Rein in the Keir v Priority Management, and others, significant court time is taken up with arguing, does it actually apply or not? In the end Justice Rein gives a summary, which actually uses three of the words and one of the other ones, but could easily be summarised as those four words. That is what he understands to be the case with the common law. If that is in the bill, all that court time would be saved is my understanding, because you can appeal to the legislation, which would make litigation more affordable and therefore more accessible to franchisees.

Mr Dingli: I think in real terms if you actually have a look at Daryl Williams' submission, he is actually suggesting the contrary. He is actually suggesting that in order to determine whether someone has acted reasonably, you are still going to have a look at the facts of each particular case and you are still going to have to go to court. Therefore, I do not think the position is actually going to change. The franchisee in that particular instance is still going to have to go to court irrespective and incur legal costs. As such, I do not think it is actually going to reduce legal costs in any way. They will be the same as they are now. If you have to go to court, it is an expensive process; there is no doubt about that. It is certainly true. By having a statutory definition I certainly do not think that that is going to reduce court costs and I do not think it is going to make it any simpler, because at the end of the day, like I have mentioned, sometimes in determining whether something is reasonable it is all in the eyes of the beholder. You are still going to have to go to court and the court is going to be ultimately the ones that are the beholder of whether or not something is constituted as reasonable or unreasonable.

The CHAIRMAN: Unfortunately we have run out of time. Thank you for your submission today—it was very good—and your feedback. There are a number of questions that we have not been able to ask you today. Would you be willing to answer a series of these questions if we submitted them to you?

Mr Dingli: Sure, absolutely—be delighted.

The CHAIRMAN: A transcript of this hearing will be forwarded to you for correction of minor errors. Please make these corrections, return the transcript within 10 working days of the date on the covering letter. If the transcript is not returned within this period, it is deemed correct. New material cannot be introduced by these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on a particular point—I would ask you to do so particularly in reference to Professor Terry's, if we can get the evidence on that debate—please include a supplementary submission for the committee's consideration when you return your transcript or otherwise talk to Tim.

Mr Dingli: Thank you for the opportunity—really appreciate it.

Hearing concluded at 4.23 pm