

FRANCHISING BILL 2010

Second Reading

MR P. ABETZ (Southern River) [4.01 pm]: I move —

That the bill be now read a second time.

Before I commence my speech, I would like to express my appreciation to those members of the public who have shown interest in this issue and are in the public gallery.

Franchising is a very rapidly growing section of the small business sector. It was estimated that in 2008 there were some 70 000 franchise units operating in Australia employing some 413 000 people. Most franchisees are people who are entering the world of running their own business for the first time. In Australia only 10 per cent of franchisees have more than one franchise, thus the Australian franchise market is very much a mum and dad investor market. The franchisor–franchisee relationship has the potential to be mutually beneficial. It allows the franchisor to grow its brand and market share by tapping into the energy of the franchisee who is keen to invest and build his own business. Likewise, the franchisee seeks to benefit from the support and business systems developed by the franchisor. However, the risks are not evenly spread between the franchisor and franchisee. The franchisor takes some risk in accepting a new franchisee. However, if the franchisee does not perform satisfactorily, the franchisor can usually terminate the contract without much difficulty and put in a new franchisee. On the other hand, mum and dad franchisees have usually mortgaged their homes and put their life savings into the purchase of the franchise. If they fail through lack of support from the franchisor, or for any other reason, they often lose their life savings, their home and, more often than not, their self-esteem and confidence, which at times steadily deteriorates to the point of even suicide. Franchisees are prepared to take the risk of getting into a franchise because they believe that the support and guidance of an experienced franchisor will minimise the risk of business failure.

New franchisees always start out trusting their franchisor; otherwise, they would not invest in one of its franchises. They trust the franchisor, and they trust that the franchisor will provide them with management advice and support, and they trust that the business systems of the franchisor will assist them in running a successful small business. This element of trust is an essential component of a successful franchisor–franchisee relationship; indeed, it is what makes the franchisor–franchisee agreement so different from any other commercial contract. Many franchisors live up to these high expectations of trust, which are essential for a franchise agreement to be mutually beneficial. However, there are a small but significant number of rogue franchisors in the market who are undermining confidence in the franchising sector by their unethical and predatory conduct. This leads to ordinary mum and dad investors losing everything through no fault of their own.

At the heart of this ongoing problem in the franchise industry is the lack of real reform that addresses the fundamental inequities that exist between franchisees and franchisors and the abuses of those inequities by rogue franchisors. Although there inevitably needs to be disparity of power in a franchisor–franchisee contract, to allow a franchisor to adjust the business model according to market opportunities and changes, the various parliamentary and government inquiries conducted to date have concluded that franchisees need further protection from rogue franchisors. As the federal parliamentary Joint Committee on Corporations and Financial Services report “Opportunity not opportunism; improving conduct in Australian franchising”, which was published in December 2008, reported—I will refer to it as the Ripoll inquiry—this disparity of power has led to an unacceptable level of predatory and opportunistic behaviour, including encroachment; kickbacks; churning, which is the franchisor terminating the agreement for no good reason or trivial reasons and then reselling the business to a new franchisee; non-renewal; transfer, termination at will; and unreasonable unilateral variations to the agreement. Other examples of opportunistic conduct include grossly inflating the price of the goods the franchisee is required to purchase from the franchisor.

The Ripoll inquiry made 11 recommendations, but to date the federal government has failed to act on most of them. The Franchising Bill 2010 addresses the issues addressed in the Ripoll inquiry’s recommendations 8 and 9; namely, that the Franchising Code of Conduct be amended to include the requirement for all parties to act in good faith in relation to all aspects of a franchise agreement, and that there should be financial penalties for breaches of the franchising code. The South Australian Parliament has also conducted an inquiry into franchising and also included recommendations for these two reforms. In Western Australia, Mr Botham was appointed by the Western Australian government to conduct an inquiry into the operation of franchise businesses in Western Australia, which was reported on in the report “An Inquiry into the Operation of Franchise Businesses in Western Australia” to the then Western Australian Minister for Small Business. Mr Botham stated on page 13 of the report that allegations of misconduct put to the inquiry were serious and involved devastating financial and family costs. He further stated in his covering letter to the minister that submissions to this inquiry reveal that

further improvements to the Australian franchising operating environment are not only desirable, but necessary. Mr Botham further stated in his report at page 5 that there is still a governmental duty to ensure that an appropriate legal framework exists to protect the interests and rights of parties to the contract.

The Western Australian state government's response to the Botham report was to take to the Small Business Ministerial Council in May 2008 the proposition that a well-defined obligation for parties to bargain and negotiate in good faith should be part of the Franchising Code of Conduct. This was endorsed by all state ministers. The Federal Labor Party went to the 2007 election promising to bring in a good-faith provision in the franchising code but failed to act on this promise. Inquiries to the office of the new Minister for Small Business in the Gillard government indicate that the federal government does not intend to act on the remaining recommendations of the Ripoll report. Indeed, the federal Minister for Small Business announced on Monday that the federal government was not planning to review or make any changes to the Franchising Code of Conduct until at least 2013. In the light of this federal government inaction, on Friday, 1 October 2010 the South Australian Minister for Small Business, Tom Koutsantonis, announced a small business package that centres around providing franchisees with a more level playing field, including the provision of good-faith and financial penalties for breaches of the Franchising Code of Conduct.

The Franchise Council of Australia, which mainly represents the interests of franchisors, has consistently opposed any moves to provide further protection to franchisees. The FCA made a submission to the Ripoll inquiry, and paragraph 8.44 of that inquiry's report reads —

... the FCA later indicated that they would not object to a good faith clause that simply reiterated any existing implied common law requirement to act in good faith.

However, recent public comments from the FCA indicate that they are not even supportive of this small level of extra protection for franchisees.

However, some significant franchisors, such as Jim Penman of Jim's franchises, have in recent times broken ranks with the Franchise Council of Australia and have also called for greater protection for franchisees as they consider the rogue franchisors to be damaging the franchise sector's generally good reputation, making it more difficult for ethical operators to attract franchisees. PricewaterhouseCoopers' franchise sector indicator report for 2009–10, which involved a survey of 106 franchising systems in Australia in 2010, showed that while franchising is in quite good financial health, one of the great challenges franchisors face is getting people to sign up as franchisees.

It has been argued that franchisees and franchisors should be free to enter into whatever kind of contract they wish, but franchising is, by its very nature, not a simple contract. The franchisor, through the franchise agreement, reserves for itself the power to alter the nature and the scope of the franchise relationship during the course of the relationship. While this power, in the hands of a good franchisor, can for example be used to respond to changing market conditions or to strengthen the franchise, the power can be, and is, abused by rogue franchisors to the detriment of franchisees and gives the whole franchising sector a bad name.

By its very nature, for franchising to work well, it requires a higher level of mutual trust and respect between franchisor and franchisee than would normally be required for other contractual arrangements. It is for this very reason that the franchising code of conduct was developed under the regulations of the Trade Practices Act and a statutory duty of good faith has been strongly supported by recent bipartisan parliamentary franchising inquiries.

The report "Franchising Australia 2008" produced by Lorelle Frazer and her team from the Griffith University Asia-Pacific Centre for Franchising Excellence reports that 25 per cent of franchisees do not trust their franchisors. Trust is a difficult commodity to pin down. The level of trust can go up and down, depending on the circumstances and the situations that may not have been foreseen at the time the parties entered into the relationship. Given that trust is an essential component for a successful franchisor–franchisee relationship, it is clear that many of these arrangements are currently operating suboptimally.

I want to make it clear that this bill is not about changing the structure of franchising agreements. It is about the conduct expected of those who negotiate and enter into such agreements. The bill is concerned to ensure that the parties adhere to generally acceptable standards of conduct, firstly, to abide by the franchising code of conduct or risk financial penalties under the bill, and, secondly to act in good faith in the lead-up and throughout the franchising relationship, including the renewal or possible renewal of the relationship.

The bill also codifies the term "good faith". In common law there long has been an implied duty to act in good faith when entering into contracts. A careful review of the case law and the legal literature in Australia and overseas demonstrates that the meaning or essence of "acting in good faith" is acting fairly, honestly, reasonably and cooperatively. The bill, by stating that good faith means to act fairly, honestly, reasonably and cooperatively, intends to codify the current common law understanding of "acting in good faith". While other words may from time to time be used to describe "acting in good faith", the words to act "fairly, honestly reasonably and

cooperatively” encompass the meaning of these other words. A clear definition in everyday terms of what the obligation “to act in good faith” means, which this bill provides, will be far more helpful for franchisors and franchisees than to try to understand what the common law obligation to act in good faith might mean from time to time.

This bill will not impose any additional costs on good franchisors, nor will it require them to change their business conduct because the essence of good franchising is to act fairly, honestly, reasonably and cooperatively. Good franchisors are already adhering to the franchising code of conduct and acting fairly, honestly, reasonably and cooperatively towards their franchisees. It is only the rogue franchisors who fail to fully comply with the code and abuse their power that will need to come into line. Their coming into line will help to protect the generally good reputation that franchising enjoys. This bill should have the effect of making the Western Australian franchising sector more appealing to prospective franchisees and help provide what Mr Botham called for; namely, an appropriate legal framework to protect the interests and rights of parties to a contract.

The bill gives the Western Australian Commissioner for Consumer Protection the power to prosecute parties who fail to adhere to the franchising code of conduct. This fits in well with the commissioner’s current responsibility under the Western Australian fair trade legislation. This responsibility can be transferred to a Western Australian small business commissioner, if such an appointment were to be made.

This bill at last gives this Parliament the opportunity to decide whether or not it wishes to provide Western Australian franchisees the protection that repeated bipartisan parliamentary and other inquiries have recommended.

In conclusion, I wish to thank the parliamentary drafting office for its work in drafting this bill and for the way that Associate Professor Frank Zumbo of the University of New South Wales has given so freely of his time to help frame this legislation, and the various legal experts in franchising who have also contributed their knowledge and expertise.

This bill will assist the franchising sector and the many small businesses within that sector to continue to grow and to develop in a more healthy and robust way.

I commend the bill to the house.

[Interruption from the gallery.]

The DEPUTY SPEAKER: You are welcome to sit in the chamber to listen to debate, but you are not to clap or make any noise or speak.

Debate adjourned, on motion by **Mr D.A. Templeman**.