# ECONOMICS AND INDUSTRY STANDING COMMITTEE

## FRANCHISING BILL 2010

**TRANSCRIPT OF EVIDENCE**
**TAKEN AT PERTH**
**MONDAY, 4 APRIL 2011**

**SESSION TWO**

**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)**

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**Hearing commenced at 12.50 pm**

**COWIN, MR JOHN**
**Chairman, Competitive Foods Australia Pty Ltd, examined:**

**CASTLE, MR TIMOTHY DAVID**
**Lawyer, Competitive Foods Australia Pty Ltd, examined:**

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

**The Witnesses**: Yes.

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

**The Witnesses**: Yes.

**The CHAIRMAN**: Did you receive the "Information for Witnesses" briefing sheet regarding giving evidence before a parliamentary committee?

**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 has received your submission. Thank you for your contribution. Do you wish to propose any amendments to your submission?

**Mr Castle**: Not directly amendments, but we did provide a reply submission to the department's submission, which we provided to the minister and we forwarded a copy of that as a matter of courtesy to the committee. We would be content for that to be received and published by the committee if that is what you wish to do.

**The CHAIRMAN**: We will respond to that. Before we ask any questions, do you wish to make an opening statement?

**Mr Castle**: Yes, what we thought we might do, in what I appreciate is a fairly short time frame to cover a lot of ground, is we might speak very briefly to the terms of reference and just highlight a couple of key points. Then Mr Cowin, who really has been part of franchising in Australia since it first started effectively in the late 1960s, would like to say a few words to provide some perspective. Then after that, obviously, answer the questions and we have a few things that we would probably like to raise that we have seen in other people's submissions, but that may well come out in the questions as well.

I should just start by indicating my personal perspective. I have been involved in acting for Competitive Foods since the late 1990s when I was involved as one of the barristers in a legal case called Hungry Jack's v Burger King, which is one of the leading franchise cases where "good faith", "duties of cooperation" and so on first got an airing in Australia. So I have a long background. I have actually worked for part of my time in 2008 as general counsel for Competitive

Foods and participated in all of the three inquiries in 2008. That was the Bothams inquiry, the South Australian inquiry and the Ripoll inquiry, so I have a lot of perspective there. Also, I am currently acting in my law firm role for the Wendy's franchisees, but I cannot talk about that because they are in mediation at the moment. So there are confidentiality restrictions there. That is just by way of personal background.

In terms of terms of reference, we think the three questions you have asked in the terms of reference are exactly the rightly questions to ask. The first question, which is on legal validity, there is an almost unanimous "yes", which has been given by everyone who has commented before the inquiry, and I think you will have noted that. We went to the trouble to brief Daryl Williams, the former federal Attorney General, to get his advice. I know that the Retail Traders Association briefed Malcolm McCusker to get his advice. We had previously briefed a Sydney barrister, Alan Robertson, to get his advice. All of them unanimously are in support of the validity of the bill. The Law Council's written submissions—you just heard from them, but they say the bill is valid. The department says the bill is valid. So there is really no question that in terms of legal validity, the bill if passed would be a valid bill for the WA Parliament.

The second term of reference is "Would the bill enhance the purpose of the code?" We make the point that the Franchising Code is a code of conduct and the one thing that is missing from the code of conduct is any conduct standard. You have heard this morning, you have read the submissions and you will hear a lot from basically two sides in this debate about "good faith". I think you would be excused for believing that with a lot of those submissions opposing what Mr Abetz has put forward, you are in a hall of mirrors. It is a bit like a Jackie Chan movie where you are trying to actually work out what it is that you are trying to attack, because everywhere you look it is uncertain. Then when you say that is uncertain, and you say but is not the answer to define it—no, that is uncertain. So we do not have a definition and that is uncertain. So you are caught in this continual maze, and the reason for that, quite frankly, the reason for the hall of mirrors, is that the people who oppose the bill will take whatever argument they can and raise it to find a problem, but the will not be offering a solution.

Listening to the previous submissions from the Law Council of Australia, the question was asked, "Is this a good expression of the 'good faith' concept?" The answer was given, "Oh, the Law Council supports good faith". There will be a lot of saying "We support good faith and we do this in good faith and we believe in good faith", but nothing that you can put forward to actually crystallise that will satisfy the opponents of the bill. They will say it is uncertain or there are unintended consequences or it is retrospective—one of the points that has been frequently raised and demolished now by the Law Council as well as the other opinions we have referred to. The question is: how would you actually fix it? If you say there is a problem with this definition, you could ask the Law Council how they would fix it. There is no positive suggestion coming forward. The department has not put forward a positive suggestion. Nobody who actually says they support good faith is actually going to give you an alternative formulation of the words. The question is: why? The answer is: they do not want it.

A judge in Queensland in a case called Seal-A-Fridge who recently had to deal with a franchise case about unconscionability said "Good faith" appears in over 160 commonwealth acts. That is paragraph 12 of the Seal-A-Fridge judgement. The word "reasonable" is a standard that is in 140 commonwealth acts. This is not rocket science. I mean, in the United States there is a general standard for contracts of good faith and fair dealing. We are not talking rocket science here, but yet you would think that you are in the most complex and difficult realm of law.

We have supported our opinion. We have supported the definition in the bill with an opinion from the honourable Daryl Williams, who says these words, "fairly", "reasonably", "honestly" and "cooperatively" are all ordinary words. Ordinary people understand what they mean. They are not difficult concepts. What you hear from the Law Council today is, "How would a judge deal with

this? How would a judge deal with that?" The fact is there are 10 000 franchisees in Western Australia and they have to deal, every day, with issues dealing with their franchisor. If you have in legislation a clear formulation—four clear words—just like you find in industrial legislation, clear words, clear concepts, people understand people can negotiate and discuss those. We say that good faith enhances the purpose of the code, it puts a conduct standard in the code and people can apply it in their day-to-day dealings, not in the far-off world of when it might go to court, but day to day.

On the question of civil penalties, we make the point that civil penalties have been recommended by every inquiry in 2008 to give the code teeth. To give you an example, in the Seal-A-Fridge case that I referred to, the ACCC prosecuted a business that repaired seals on fridges. Justice Logan in the Federal Court found that this particular franchisor had breached the code because he had either not kept his franchise disclosure document up to date or he did not hand it out when he was supposed to. He was found to have breached the code. What was the penalty? The penalty was a declaration he had breached the code, but that is not going to stop people breaching the code. He was ordered to go to a seminar. That is the consequence of breaching the code—he was ordered to go to a seminar. It did not matter what damage he had done to the franchisees. The code lacks teeth. Civil penalties will put those teeth back into the code. It is just like having—we have said it in our submission—speed limits. The only way you stop hoons is by putting in speed limits. The only way you stop people crossing through red lights at pedestrian crossings is by putting in red-light cameras. You have to have penalties.

As to terms of reference (c), the cost impact, we have put forward that the cost impact of what is proposed in the bill is minimal. None of the submissions have talked about the benefits. We have. There is no new red tape. There are no new documents. People do not have to go and rewrite their contracts. People do not have to rewrite their disclosure documents. There is one suggestion that people would have to put a special section in their disclosure documents about WA and so on but franchisors are obliged to update their disclosure documents every 12 months. Adding in any additional information to deal with what is happening in WA is part of what they would be doing anyway, just like they would under any other state law in any other place where they are operating. There is no extra compliance cost. Somewhere we saw a reference to the fact it would cost $10 000 per franchise. That is nonsense. In its Regulatory Impact Statement for the 2010 amendments, the federal government estimated the cost of extra compliance for franchisors of $10, not $10 000, to understand what the new requirements involve under much more extensive changes. There are significant benefits in lowering the risks to franchisees. The department has said that the direct cost of this new law would be $1.6 million—one per cent of the department's budget. It makes no allowance for the recovery of fines, it makes no allowance for the fact that the courts will give costs orders if the department wins, and it makes no allowance for the benefit to franchisees.

We talked about the fact that there might be 10 000 franchisees in Western Australia. If we think about it, your average franchisee generally invests because they take the equity in their home and their superannuation payout. From that basis, we can say that the average price of a house in Perth is around $400 000 or $500 000. Unfortunately, house prices keep climbing. We might postulate that the average investment by franchisees is around the $300 000 mark. Even if it costs $1.6 million, to take the department's estimate, you would need to save the finances of only five franchisees per year and the benefits of the bill will pay for itself. We are talking about 10 000 franchisees. Let us assume that this measure benefits one per cent of those franchisees—1 000 franchisees. When you take into account the benefit that flows to franchisees, we can see that overwhelmingly, even if there is a cost impact, it is minimal but it is well and truly outweighed by the benefits. We say, as we put in our submission, that the benefits of this bill are clearly justified on that score. You will not find in any of the opposition submissions to the bill any reference to the benefits and a lot of speculation, we would suggest, with respect to costs.

The committee would be entitled to give a tick to this bill on each and every term of reference for the reasons that we have set out. We can develop some of the other points in a moment. Before I

hand over to Mr Cowin, there is one pervasive myth I want to address. This is not a bill that reinstitutes the narrow-gauge railway. No-one has to get off the train when they come over the WA border; they just have to behave themselves on the train exactly the way they are meant to. If they do not behave themselves, they will get pinged because they will be liable for civil penalties or there will be a clear statement of a good faith duty. All this talk about narrow-gauge railway and all the other scare campaigns, slogans, myths and so on that have generally been promoted by the franchisor lobby should be seen for what they are. It is a smokescreen to avoid confronting the fact that there is a real problem and in our respectful submission to this committee, this bill offers a real solution.

**Mr Cowin**: Forty-two years ago this next month I moved from Canada to Perth, Western Australia, with a six-month-old child. My father worked for the Ford Motor Company in the east. When I was in high school, I came to Australia, living in Geelong for six months, so I was predestined to come and visit. When I did, I came and paid $1 000 for a Kentucky Fried Chicken franchise in Western Australia.

**The CHAIRMAN**: Was that the first one of those franchises in WA?

**Mr Cowin**: Yes, it was. I packed up my wife and child and moved here. I did not have any money—I was 25 years old—but I got 30 Canadians to lend me $10 000 each, so I had $300 000. They were shareholders in the business. So I say thank God for the free enterprise system and people who are prepared to back venture capitalists. I opened our first store in December 1969 on North Lake Road, Melville. It was a big success. Over the years, we opened 50 stores. A couple of years later we got into the hamburger business with Hungry Jack's. There are 350-odd Hungry Jack's stores around the countryside in which we are the franchisor. We are the master of that particular contract that we run with an American company called Burger King. We have a unique perspective of being a franchisor and a franchisee. Not too many people are in that category. We got into the food manufacturing business in the mid-1980s. We got into the pizza home delivery business. Today Competitive Foods, which was that original North Lake Road/Canning Highway business, employs in excess of 16 000 people. We export food products, mainly frozen beef products, to 29 countries around the world. It has been a great adventure over its last 40-odd years.

Being a franchisor and a franchisee, we had somewhat of a unique perspective. We sailed along quite handsomely without any conflict because our business had been a success. We ran into some difficulties, which I think is probably pervasive within the industry in that the franchise industry basically takes other people's money and other people's energy and the franchisor generally owns the trademark and the franchisee puts the money up for the store, the location, and it is through his energy that the business gets built. During the expansive growth period, that is terrific in that everybody is pulling in the same direction. When the growth stops, all of a sudden the franchisor has to find new ways of creating revenue. If there is a business that we do not have to renew the franchise contract on, here is a great business opportunity for us to absorb that into our network. That was the type of situation that we found.

To make a long story short, I think that the essence of what this committee has to deal with is an imbalance of power on a contractual basis between a franchisor and a franchisee. That imbalance of power arises basically because there is an initial contract that the franchisee enters into. The difficulty is that that contract is a living, changing document. The initial contract is built on other things that happen as you go along—changes that you have to make to the business, modifications that you have to make through an operations manual and things like that. As this contract evolves, the franchisor remains, until the very end date, in the position to change the rules. As we have embarked down this particular road, I was in Perth a couple of weeks ago and we had a meeting with a franchisor. We talked about why we felt that some of these changes were good for the industry. This particular individual pushed back and said, "Why should I give up any advantageous position I've got contractually for a franchisee if I don't have to?" The way that the local law is

currently written, they can say, "I don't have to, so why should I give up any benefits, ethically or unethically, as to whose money it was and who built the business and all the rest?" Our answer to them was, first of all, because it is the right thing to do. This is not like a Westfield lease whereby you can move out at the end of the lease and take your shoes or whatever you are selling and move to the shopping centre next door. This industry has been described as a partnership in which we have to look after each other's respective positions.

One of the things that flow from that is that, at the end of a period of time, it is not like your lease is up and you have to move out. In this particular case, there is a restraint; you cannot be in the same business. If the franchise contract ends, you are restrained from remaining in that business. It is a partnership. As I say, one party owns the trademarks and one party puts up the money and the energy. Good faith becomes an inherent part of good business practices. The problem that we have in Australia today is that there is this imbalance between the rights of the initial contract that someone enters into and how this evolves and whether or not at the end of the period of time there is an incentive for the franchisor, if he so wishes, to not renew and to take that business back. That is the imbalance of power that the contract is based on. We have been through the Matthews committee, the Ripoll committee and the local committees here. They have interviewed mass quantities of people as they have gone through. Our business is a substantial business. It started as the small acorn and we built a fairly substantial business. The great bulk of the 10 000 franchisees in Western Australia that Tim referred to are largely mums and dads. The mums and dads do not have the wherewithal to push back and defend themselves. Until we took this on, as we felt it was an injustice, I do not know of any other situation in the business society in which anyone has been able to stand up to the franchisor lobby, which has wanted to keep the power in its hands. One of the issues that I think you should raise when you deal with them is that they were also opposed to the franchise code: this was not a good idea; now it is accepted. They are pushing back on good faith as a reason for a good business practice to follow. It is the imbalance of power and the inability of the mums and pops to defend themselves. What happens is that the franchisor says, "We're not going to renew your franchise contract." As a result of that, there are restraint provisions within the franchise contract that prevent people from doing what we are doing—that is, saying that the law needs to be changed. If the law is changed, the courts can then interpret what that law is in respect to the individual cases as they come along. I think that is an opening volley for me.

**The CHAIRMAN**: I suppose that your argument and support for the bill are predicated on the basis of your own experience, which is very fundamental, and the legal area. You made the point repeatedly, Mr Cowin, that there is something special about the franchisor–franchisee relationship, otherwise we would not be here. There are a lot of businesses dealing with multiple contracts, many of which have had troubles. This deals with that. You argue that there is an inherent imbalance between the power of the franchisee, not so much to you but to the smaller ones —

**Mr Cowin**: To us. We just have the right to find the financial resources to embark on this exercise.

**The CHAIRMAN**: Of course. I imagine that the imbalance lies with the capacity to do something about it.

**Mr Cowin**: Correct.

**Mr Castle**: It is not just capacity; it is actually the legal framework.

**The CHAIRMAN**: Yes; let us deal with that. I will explore that; the two go together. There is an imbalance. Many of the people who are franchisees are small—as you describe it—mums and dads who are highly leveraged, often new in business and often not experienced in business, as you were, Mr Cowin, some 40 years ago. They are fragile. Also, small businesses generally have a relatively low probability of going ahead and succeeding. It is part of their entrepreneurship. So we have a delicate position. What I would like you to do is describe the origins of that imbalance so that I can understand it a bit further, and then go on to give me an explanation of why the laws that appear to apply to all sorts of imbalances in life and in business are special.

**Mr Cowin**: Your first question was about the origins. You are 100 per cent correct. When the franchisee goes into business, generally he does not know anything about the business. I am a strong supporter of the franchise industry per se, because the success ratio in franchising is better than Harry Smith hanging out his own shingle. What you are hopefully doing is learning from trial and error and from the mistakes that other people have made to end up with a formula that works. That is why franchising has a higher success ratio.

**The CHAIRMAN**: What would that success ratio be? Do you have any idea?

**Mr Cowin**: I do not know the answer—90 per cent? The success ratio is much higher through a franchise business than it is through an individual.

**The CHAIRMAN**: Small business is about 25 per cent.

**Mr Cowin**: I do not know for sure, other than the fact that it is higher. The franchisee gets into the business because he wants to learn and he takes advantage of someone else's trademark, which generally has some value. You go through the time period of a contract—whether it is 10 or 20 years—and, generally speaking, the franchisee supplies the money to buy the land, build the building and buy the equipment, so it is his investment that is on the line. If the business goes bad or does not work, he loses. He is the risk carrier in the business, generally. The franchisor's risk is the royalty income that he is able to make. As time goes on and the business expands and is more successful, the crisis comes when you have a renewal date. Generally speaking, the renewal rate of franchisees from franchisors is high, because there is a vested interest in both making income from this particular relationship. The difficulty, however, is if the franchisor says, "I do not have to renew this. There is no legal precedent that says I have to do this." The answer that I gave you is the local franchisor saying, "Why should I give something up if I don't have to? Ethically or unethically, why should I give that up? Why should I encourage the Western Australian Parliament to support this bill if I'm giving something up? What's in it for me?" The answer, as I said earlier, was, you are doing the right thing for the franchisee and you will probably get more franchisees, and they will be better-run businesses if you can take that worry or stress off what happens at the end of the contract, that you may not be renewed and you may lose the business if the franchisor so decides he wants to keep it. It is not a bad transaction for him to be able to take a proven business and be able to keep it and keep that revenue, and sell it again to someone else if he so chooses to do and keep the goodwill. In a divorce there is no one-sided situation in which the wife or the husband gets it all.

**The CHAIRMAN**: Generally.

**Mr Castle**: Can I take a slightly different angle? I hope, together, you will see how your question is answered. One of the things about a franchise is that, as Jack said, the franchisee buys into a franchise because the franchisor has already tested the market and has a brand, so you are not doing what a lot of small business people do who start out with nothing; you are actually buying into someone's, hopefully, proven system. For that reason, you actually pay a royalty off your top line—off your turnover—so you pay a franchise fee and you pay a royalty. You actually pay a form of insurance for going into small business as a franchisee. That would underscore what Jack is saying about the success rate of franchisees. I want to take an example about store upgrades operators: if you walk into a Hungry Jack's store, every Hungry Jack's store has to look the same and has to have the same items on the menu. If you want a Whopper in your local store or if you go to a Hungry Jack's store while on holidays and get your Whopper, it will be exactly the same Whopper. As a franchise chain you offer a degree of standardisation so that the customer then knows this is what the brand offers and I can trust it. If you have not seen a franchise contract, I suggest quite strongly that you might ask some of the franchisors who come before you to give you a look at their contract, and I think what you will see is the heavily one-sided nature of these contracts.

This goes to your original question: the contract will say that the franchisor has the power to direct the franchisee to have its premises at the current store or outlet image, and that it can change the store image at its discretion—normally at its absolute discretion—and then everybody has to

upgrade. So what about this situation? I will give this as a hypothetical example, but it is not an uncommon one: someone in franchisor headquarters decides, "Okay, we want to do something different with our store image; we want to make it more relevant", so they tell their franchisees, "We want you to upgrade your store, fit it out a particular way with different colours, different equipment, and a different layout of the store", and the franchisees, under the contract, have to comply. The origin of the imbalance is the contractual power.

What if you have this situation: the franchisor three years ago, said, "We're going to have a major upgrade and refresh our image", and mum and dad franchisee says, "Okay, I have to comply", and goes to the bank and borrows money against the equity in their house—the house value has gone up so they can borrow another $100 000—for a five-year loan to do the store upgrade. Three years into that they are told by the franchisor that somebody in the franchisor headquarters has said, "Oh, listen, that upgrade we did three years ago has not really attracted the customers; we need to upgrade again", and so they say, "We're going to do another upgrade." But the franchisee still has another two years of their fit-out loan to pay off and says, "I can't afford to do it." The franchisor says, "Well, the contract says you have to do it; I have the power to make you do it."

So what does the franchisee do in that situation? This is the real benefit of the bill that Mr Abetz has put forward: the franchisee says, "I can't; we're in a dispute." The franchisee says, "Oh, I've got this common law notion of good faith out there; that's going to save me", and they turn up to a mediation hearing—because the code provides a good mediation process—and they say, "I can't afford to do this." The franchisor says, "This is your contractual obligation; you have to do it." The franchisee says, "But I've got this common law duty of good faith", and if he goes down to the court a couple of years later some judge, in a very nuanced way—according to the Law Council's submission—will do a little bit of individualised justice, and the franchisor says, "Look, you either upgrade or we terminate." The franchisee then has to either go and hock the house further or sell the business; that is not an uncommon situation.

Now, think about a different situation with Mr Abetz's bill on the table: we go to the mediation, the franchisor says, "My contract says you have to upgrade your store", and I turn up for the franchisee and I say, "Hang on; section 11 of the franchise act says you have to act honestly, fairly, reasonably and cooperatively. Acting fairly and reasonably in this case, the franchiser will give the franchisee another two years to pay out his last fit-out loan, and then he will go to the bank and borrow money for the fit-out." So they will actually compromise and the franchisee will not upgrade now just because the franchisor has the power to say so; they will actually compromise and come to a sensible solution. So the real benefit of this bill—this is what the franchisor lobby, with all respect to it, dislikes—is that the franchisee is suddenly empowered in that discussion because they can point to a piece of paper—a bill; an act of Parliament—that says fairly, honestly, reasonably and cooperatively, and people can work out what it means and you can get a fair outcome. You can get a win–win outcome.

**The CHAIRMAN**: Let us explore that example; I will just take it as you have outlined it.

**Mr Castle**: Yes.

**The CHAIRMAN**: Franchisors have the brand name maintenance and they spend money on it by advertising—you do a lot of advertising; I do not know what power you have over young kids, but it is powerful—and they also have the maintenance of quality control, standardisation, collective advertising, colours and all that sort of stuff, which are things I do not understand, but clearly it is done, and sometimes they work, sometimes they do not. People change their brands all the time in response to success and in response to competition.

**Mr Castle**: Yes.

**The CHAIRMAN**: So your situation is that of a franchisee already having debt from his last upgrade and the franchisor deciding—you would presume with justification, otherwise why do it—

that something is not working and he has to do it again because there is this need to provide uniform presentation because the franchisor does not want one franchise down in Albany stuck in the old system and the one up in Mandurah on the new system; you do not want that generally.

**Mr Castle**: Yes.

**The CHAIRMAN**: That is one reason why you go into a franchise rather than run your own business. I do not know how this bill would alter that at all.

**Mr Castle**: The bill would alter it because the franchisor would not be able to just say, "This is what the contract says; you must comply with the contract." It would actually force people to look for compromise outcomes where compromise is possible.

**Mr W.J. JOHNSTON**: But that is not right, is it? All this would do is provide a remedy if good faith was not in place.

**Mr Castle**: That is a very good question. It does not just provide a remedy; it takes good faith from being something that happens four years down the track in court when a judge decides, to something the franchisor has to confront now when he or she makes the decision, because they know that is an obligation they have to comply with.

**Mr W.J. JOHNSTON**: How is that enforced?

**Mr Castle**: I suppose it is enforced in the same way any law is enforced. If people know there is a law there, then people adjust their behaviour accordingly.

**Mr W.J. JOHNSTON**: Or they go to court.

**Mr Cowin**: Or they go to court.

**Mr Castle**: Or they go to court.

**Mr Cowin**: I think that is the short answer.

**Mr Castle**: Yes. This bill actually makes clearer the basis upon which people can go to court.

**The CHAIRMAN**: I am not sure in this case that it does at all. Let us say you have to go and change the colour or pattern of your shop.

**Mr Castle**: Yes.

**The CHAIRMAN**: Now this problem applies to shopping centres enforcing on small businesses; as local members we get this all the time.

**Mr Castle**: Yes.

**The CHAIRMAN**: Upgrades are not unusual and they are not hypothetical, really. But in a franchise you sign a contract, they are in charge of brand name. That is an absolutely vital part of the contract and success of your business. As you have laid out before: if the franchisors decide, hopefully based on some evidence, that they need to upgrade things, they need to upgrade.

[1.30 pm]

**Mr Cowin**: The principle, I understand; you are right. But let us look at the small percentage of franchisors that may not want to do the right thing. Take the example you just painted. Let us say I want to buy your business and I want to buy it cheap. Then, all of a sudden, I can put some pretty draconian things on you which, at the end of the day, you say, "I'm not going to do this—it doesn't make any economic or commonsense." The franchisor says, "Okay, your franchise contract is cancelled, or you sell me the business and I'm going to buy it from you cheap." That is what happens; that is the reality. The mom and pop do not have the resources to be able to push back. So, you are right, the change of leverage and things like that, those are kind of everyday sorts of things. Where you get into this situation whereby somebody wants to take economic advantage of that

franchisee, because he has a successful business, there is no way in which that franchisee has any protection. That is what this legislation endeavours to achieve.

**The CHAIRMAN**: One of the examples is, if I was the franchisor and I said, "We have to do this upgrade. Sorry, we did it two years ago but the world is competitive." Someone comes to me and says, "I don't have the dough"—that is their problem, right; cash flow and what-not. But then the issue is: is the guy acting reasonably?

**Mr Cowin**: Correct.

**The CHAIRMAN**: Is he trying to drive them out of business —

**Mr Cowin**: Correct.

**The CHAIRMAN**: — picking on certain ones?

**Mr Cowin**: Good faith—is he operating with good faith?

**The CHAIRMAN**: As to the example you reiterated; that is, someone should not have to adhere to their brand name maintenance, an investment in the brand name as agreed; I do not think this thing would change anything at all.

**Mr Castle**: But can I just say a couple of things —

**The CHAIRMAN**: Mr Cowin's example, if there is evidence that they are actually using this in an unconscionable way to drive someone out of business, that is a completely different game.

**Mr Cowin**: As I said, we are strong supporters of the franchise industry. You are going to hear from the FCA—I am in the hall of fame of the FCA, even though they do not talk to me anyway! However, I am just saying we are strong supporters because I would not be here today if it had not been for the franchise system. There are rogue elements in any business. Is it a large element? No. Is it out there? Absolutely. Do people try to steal other people's businesses by taking advantage of the lack of teeth in the current legislation? Absolutely, yes. That is why we have to have the courage to be able to move this legislation forward, and it will improve the situation.

**Mr Castle**: Can I just respond and drill down a little bit into your comments, Mr Nahan? The first comment I make is that when the franchisor is making a decision about an image upgrade, they do not actually have any skin in the game. That is a key point that Mr Cowin made earlier. The people who have the skin in the game is the franchisee because it is their investment, it is their money. That is the first point. They are making a decision about an image upgrade where they are spending other people's money.

**The CHAIRMAN**: They do have skin in the game. If their brand name deteriorates, they lose money through IP payments.

**Mr Cowin**: I agree with that.

**Mr Castle**: But that comes into the second element which is their incentive. Their incentive is actually to maximise revenue, not profit.

**The CHAIRMAN**: It depends on the contract. It depends on the contractual form. Let us take Hungry Jack's. Its brand name was crucial both in terms of the operation and expansion. You had upgrades of all sorts, I notice. My children went to it very often and they noticed it. You got returns on the success of your brand name by pulling people in overall, as opposed to your competitors. You do have skin in the game. You also do advertisements—I believe you advertise collectively.

**Mr Cowin**: Yes.

**The CHAIRMAN**: And quite heavily.

**Mr Cowin**: But I can give you an example currently whereby the franchisor, if he wants to impact on the business, withholds the advertising money and does not allow that money to be spent in the

market because that then diminishes the value of the franchisee's business, which he has a vested interest in being able to —

**The CHAIRMAN**: I have no doubt in the franchisor–franchisee's business there are disputes. This is a competitive world and some people exploit the laws, especially the cost barrier to access justice. There is no doubt about that. But this is a thing that applies to all of them. I was actually quite worried—it sounded like you were trying to use this act to change the balance between franchisors and franchisees; that is, how the franchisees actually have some rights to dictate the rollout of brand image. I do not know if it is good or bad, but that would be improper use of legislation to effect contracts.

**Mr Castle**: That is not what I am suggesting. The example which I gave was that the franchisor says, "We want to have a brand upgrade", and the franchisee's position is, "I cannot afford it for another two years, so can we look at a way of deferring?" In some cases you will not be able to defer things. Some things have to be done immediately, but where compromise can be achieved—really this goes to what we say is a bullying culture which exists within the franchise, certainly within some elements of the franchise industry, it makes those who would otherwise use their power in a dictatorial way, actually look and say, this is the point of cooperation, "You've got interests in this too, how can we come up with a win–win solution for the brand and for you; what you're trying to achieve?"

I think we have got to be careful not to generalise from what we are dealing with, which is putting in place a minimum conduct standard that is going to catch, as we say, the hoons in the industry, the rogue traders in the industry, and make them think about it. In fact, the best evidence of this comes from the FCA's submission. On page 12 of their submission they say the effect of this bill is that there will be an acute focus on compliance within organisations to ensure individuals are not subject to personal liability orders. In other words, the act will have the consequence of making those people who would otherwise just ride roughshod over the franchisee actually think about compliance. It is compliance by penalties enforcing the code. It is compliance by making the good faith duties, which everybody out there says exist, and bringing them into legislation so that people have to deal with them upfront and not game, with all respect, the legal system, by saying "catch me if you can".

**Mr Cowin**: I understand where you are going with your comment, but that is not what we are dealing with. What we are dealing with here—we are a franchisor, we have to deal with franchisees as well. Jim Penman is the largest. He has more franchisees than anybody else. He is very supportive of this. What we are dealing with in essence is good faith. What we are talking about here is: is the franchisor dealing in a fair and equitable manner with the franchisee at his request? Is this being done even-handed to his best interest and your best interest? Under a partnership, as I said, we look after each other's interests. Where that gets out of line, where I am doing something to my advantage and to your disadvantage—that is, I would like to buy the business, I would like to buy it cheap—that is not good faith, unless you have some other reason. Should the franchisor have the right to not renew, to not do things? Absolutely, if you are dealing with someone that is not operating the business correctly. Your kind of comment about the franchisee trying to dictate whether you will or will not have an upgrade—no, that is not on the table. What we are talking about is where somebody is not operating with good faith. The definition of good faith is the Daryl Williams sort of four magic words.

**Mr W.J. JOHNSTON**: We are running out of time; there might be things that you want to make comment on later. I want to explore a bit the question of the end of a relationship. I am a former union official. I used to represent members working at KFC, Hungry Jack's and Domino's. Sometimes people do not work out, they get told, "You're not working out" and let go, but sometimes you need to make somebody redundant. It might not be a question of performance, but the needs of the business. You are franchisor; can you imagine a situation in which, because of the

needs of the franchisor, there needs to be a redundancy in respect of a franchisee? If you can imagine that circumstance, how would you apply this rule?

[1.40 pm]

**Mr Cowin**: I can, and if for example we wanted, for our own corporate reasons—this happens—to obstruct a franchisee in Albany because we had someone driving by, the right thing for us to do would be to buy that business out—have the market value assessed and purchase the business, not expropriate it and open up our own business because we have the right to do so without any legislative protection. There are lots of examples where the pendulum swings one way or another, if you did not want to do it. Good faith has been badgered here, and we have said, "Okay, what does it mean?" As I say, those four words of honest, fairly, reasonable and cooperatively—I think people understand that. When Bernie Ripoll did his thing on this, he said that good faith is something that people understand. A judge in a court understands when people are being honest or dishonest. Without it being explicit in the contract, there is a wide avenue for abuse if and when. Does it happen a lot? No, but it does happen, and that is why I think the obligation is on this committee to try to provide some leadership and protection where it does happen.

**The CHAIRMAN**: I am sure that putting this in the legislation would help the general smaller franchisees think more about what it is. If there were a good faith clause, it would help them understand. I think the data is that many of them enter into these arrangements not well informed and not very much experienced in business, so it would help them, I have no doubt whatsoever. If they get into trouble in meeting their conditions and are faced with not only losing their business, but also their house, desperate people will do desperate things.

**Mr Cowin**: Yes.

**The CHAIRMAN**: Let us put that aside. As to the larger franchisor who has access to lawyers of all sorts and who will, before they set up a contract that will apply to all franchisees, get legal advice and a common law briefing on what good faith is and what its dimensions are, I have a hard time seeing how it will impact them. They are going to get, often—I think you do—a thousand of these franchisees on. Harvey Norman has many, many too, and it puts a lot of effort into these things. Having this legislation in Western Australia, I do not know how it will affect the people causing the problem as the few aggressive franchisors. They already know the laws and its interpretation and know how to work it.

**Mr Cowin**: They know right now that they can do it because there is no restriction from being able to just take the business. As I said earlier, the local franchisor here that I met with a couple weeks ago said, "Why should I give up the right to take it, even if it is unethical, because I've got that right now? Why should I go along with this legislation when it is going to restrict me from being able to do something?" We say that it is an ethical issue and it is going to help his business to have people who are onside, rather than having to worry about whether this guy can. There is no doubt about that, for the small minority—you comment about the big guy, and he does have the legal rights—but the little guy does not have the right to push back if the guy is operating in bad faith and doing it to his corporate advantage versus the right of the individual who cannot locate something because there are restrictions on what he can do. He will be in a very difficult position.

**The CHAIRMAN**: The Law Council, who you have listened to, made the statement—this is my experience with legal issues—that if you try to clarify and tighten up the laws to make them unambiguous, the big and the strong get to exploit that even further to their advantage. Is that a concern here?

**Mr Cowin**: I do not see how if everybody—franchisee and franchisor—has to operate under the premise of good faith. Good faith is about us treating each other fairly and honestly. If that is the governing essence of this legislation, that is the key. If we have to operate on a good-faith basis,

then the likelihood of you trying to take advantage of me or vice versa reduces, if I understand your question correctly; I am not sure whether I got it.

**The CHAIRMAN**: Again, it is always going to be open to an interpretation of "honestly" and "in good faith". To paraphrase what the Law Council said, it is concerned that we will try to legislate for good faith and enumerate or state what its components are. That is a restriction on interpretation and the powerful—the franchisors—will be able to utilise it more effectively for themselves.

**Mr Cowin**: Not if you have to handle the franchisee with good faith and fairness. What are you going to do?

**The CHAIRMAN**: You potentially have a more restricted, enumerated definition of what "good faith" is. It gives less flexibility to the judge in interpreting what it is. Again, that is the Law Council's argument.

**Mr Castle**: That is what it said, but it is not correct, for a couple of reasons. The first is that the words used—fairly, reasonably, honestly and cooperatively—are words that can adjust to every situation. What is reasonable in one situation will be different to what is different in another, but at least it sets a test that people have to think about what is reasonable in their situation. That is the first point. The end point of this is that what we are trying to do is to encourage people to cooperate. Franchising works because both parties need to come together to contribute money, labour, capital, brand and system. The big franchisors already have everything they want in their contracts. Why? Because these are standard form contracts; they are take it or leave it. They constantly upgrade their contracts every time a new thing comes along, so they do not need the law to deal with franchisee problems, because they can just change the contract or use an existing discretion. The law helps people who do not have that piece of paper, to come back to the mediation example. They can point to a piece of paper and say, "You've got to act fairly, honestly, reasonably and cooperatively; this is not fair, what you're doing. This is not reasonable." They will actually have something they can use on the ground at the time.

I will continue that point by reference to page 4 of the Small Business Development Corporation's submission 102. It was easy to miss, but it was a breath of fresh air to hear it state that where it is possible to clearly and unequivocally define "good faith" and its application in the franchising context, the SBDC would welcome its inclusion as a general standard underpinning the franchise relationship. The SBDC would welcome the inclusion of a defined statement—it says "well-defined", so we just have an argument about definition—into a piece of legislation. The SBDC, unlike this committee and everybody else at this stage, received a huge number of submissions, none of which were published. The committee may wish to actually call for those. They were not published because, as I understand it, there were concerns it was not done under parliamentary privilege.

**The CHAIRMAN**: As I understand it, the inquiry did not publish them for the good, sound reason of keeping confidential information, so it was not an oversight.

**Mr Castle**: Okay. In any event, it summarised on page 13 that this was the range of allegations: misrepresentation; franchise churn; collusion with banks; capricious and vexatious notices of dispute and termination; collusion with suppliers; bullying, intimidation and threats against franchisees; defamation and breaches of privacy; and refusal to enter into mediation. The list goes on. So there is a long list of behaviours. They took the submissions, and what the SBDC are saying on page 4 of their submission is that they would welcome the inclusion of this duty; provided the definition can be got right, they would welcome it as benefiting the franchise industry. The question is: why? And the answer is: to encourage cooperation; and that is ultimately the win–win outcome. It is not about what happens in court; it is what happens to the 10 000 franchisees on the ground every day when these decisions are being taken. We have said a lot about good faith. We have not talked much about costs. Is there any particular issue that you wish to raise with us about costs?

[1.50 pm]

**The CHAIRMAN**: You heard the Law Council's argument. I note that in your brief you say that there is probably no imposition of cost on government. That is true, probably. There will be some administrative cost, but it will not be overwhelming.

**Mr Castle**: And I should say there is one update there. Under the new arrangements for the Australian Consumer Law, as part of the reformulation of the Trade Practices Act—the Competition and Consumer Act, as it is now called—and the Fair Trading Act, the regulator, as it is called, in WA can enforce what was the old Trade Practices Act, or the Competition and Consumer Act. So they already actually have the power, and I think the department acknowledges it. So we are not actually adding to duties that they do not already have; we are actually adding to powers and remedies.

**The CHAIRMAN**: Yes; I agree with that. There might be some, but it will not be huge. I think the cost issue relates to the legal costs that relate to the franchisor and maybe franchisees; that is, trying to understand parallel issues, getting legal advice, uncertainty in courts—things that you would know better than I. So I think the cost is not an impost on government—I accept that—but the cost of decision making; that is, decision making in both advice and otherwise.

**Mr Cowin**: The other issue that has not come up is that there is a lot of talk about whether this should be a national bizzo versus a state. I just put forward that in Victoria, in 2003, they brought in a Victorian Fair Trading Act, and they had the courage to be able to put that in place. In 2010, it became a national law, because they were able to see the benefits of it and —

**The CHAIRMAN**: That happens often in Victoria.

**Mr Cowin**: We put forward the same basis here. If WA puts forward this legislation and approves it, we believe those same principles will then be applied, and all the kind of furphies that are raised as to why this should be a national law. The federal government has chosen not to deal with it. It is easier not to do it than it is to do it.

**The CHAIRMAN**: So the federal government has looked at this. They had a parliamentary committee. It has been around for a long time. The minister before last was —

**Mr Cowin**: Emerson.

**The CHAIRMAN**: Yes. It was on his desk. As you understand it, they have decided not to pursue this route.

**Mr Cowin**: Yes. They overcame the Ripoll committee's recommendations. They then turned it to another committee, which had a very specific brief, and one of the questions, I think you said, was, "Was good faith part of that?" and it was not. They did not deal with good faith, and we think that is the primary plank that this thing is built on. As I said, it is easier for them not to do it than it is to do it. We say that the cost of doing that is that in society and in business, there are people who are being taken advantage of, and unless there is some action taken, that will continue.

**Mr Castle**: I was just going to raise one other point—or two points. Unconscionability came up this morning. The Senate economics committee, in December 2008, produced a report in relation to unconscionable conduct. In paragraph 3.8 of that report they noted that there have actually only been two successful prosecutions by the ACCC in 10 years on the unconscionable conduct remedy. I think there is one more now, so that would be three. Then, what they said at paragraph 5.4 was that unconscionable conduct had not led to behavioural change. So I think, as we say in our submissions, it is not a panacea.

The second is, Mr Nahan, you raised with the Law Council a question about cooperation. Cooperation has been a part of contract law since the nineteenth century. What cooperation means is that actually when you sign a contract, you have to cooperate with the other party to the contract so that you can each achieve the benefits that you contract for. I do not think it is anything more

complicated than that. Daryl Williams has made reference to that in his opinion; I am referring to the Strzelecki decision in the Court of Appeal here last year.

**The CHAIRMAN**: But Mr Cowin gave us an example to say that you have a contract; the terms and conditions are understood. If the franchisor has the power under that contract to force a person into a fire sale, that is uncooperative, but it is within the terms of the contract. So the issue of cooperation goes to how you implement, and the fairness by which you implement, the powers of the contract.

**Mr Castle**: I agree with that; I agree, yes.

**The CHAIRMAN**: Okay. Good. Is there any other issue? We have to finish up.

Thanks for your evidence today. There are a number of questions that we have not been able to ask today. Would you be willing to answer a series of written questions that the committee may provide?

**Mr Castle**: Yes, we would.

**The CHAIRMAN**: Thanks. Some of those you have put in that response to another submission.

**Mr Castle**: To the department submission, yes.

**The CHAIRMAN**: A transcript of this hearing will be forwarded to you for your correction of minor errors. Please make these corrections and return the transcript within 10 working days of the date of the covering letter. If the transcript is not returned within this period, it will be deemed to be correct. New material cannot be added or introduced via these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on particular points or questions raised today, please include a supplementary submission for the committee's consideration when you return your corrected transcript or otherwise.

**Mr Castle**: Thank you.

**The CHAIRMAN**: We will be back in five minutes for the next hearing.

**Hearing concluded at 1.56 pm**