ECONOMICS AND INDUSTRY STANDING COMMITTEE

FRANCHISING BILL 2010

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
WEDNESDAY, 13 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)

Hearing commenced at 10.36 am

BRYDEN, MR NICHOLAS JULIAN
Legal and Corporate Affairs Director, KFC/YUM, examined:

The DEPUTY CHAIRMAN: I make the point for the benefit of those in the public gallery that I would appreciate it if they would turn off their mobile phones so the committee is not disturbed.

Thank you very much for your appearance before the committee today. This committee is a proceeding of Parliament and warrants the same respect that the 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 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?

Mr Bryden: Yes, I have.

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

Mr Bryden: Yes, I do.

The DEPUTY CHAIRMAN: Did you receive and read an information for witnesses briefing sheet regarding giving evidence before a parliamentary committee?

Mr Bryden: Yes, I did.

The DEPUTY CHAIRMAN: Do you have any questions regarding your appearance here today?

Mr Bryden: No, I do not.

[10.38 am]

The DEPUTY CHAIRMAN: For the record, the witness, Mr Bryden, and the committee's research officer, Kristy Bryden, are in no way related or known to each other. The committee has received your submission; thank you for your contribution. Do you wish to propose any amendments to your submission?

Mr Bryden: No, I do not.

The DEPUTY CHAIRMAN: Before we ask any questions, do you wish to make a brief opening statement that directly addresses your submission and the terms of reference?

Mr Bryden: Yes, I would like to do that.

The DEPUTY CHAIRMAN: Please proceed.

Mr Bryden: Thank you. I thought I would supply the committee with a short background to our business, for those who are not aware, and then talk to some of the key issues that are related to our submissions. I am a representative of KFC Australia and Yum! Brands. KFC Australia is a wholly-owned subsidiary of Yum! Brands. Yum! Brands is the global franchisor for KFC—Kentucky Fried Chicken, as it was known. In Australia, the system employs some 25 000 people and it comprises 600 or so restaurants, 75 per cent of which are franchised and 25 per cent of which are company-owned. In Western Australia we have two franchisees, the biggest of which is Competitive Foods Australia, and they are substantially larger than any other franchisee. We also have two company-owned stores. That is the background to the business.

As to the submissions that we made to the inquiry, we made the submissions generally, and in that capacity I appear before you as an interested franchisor. We made some submissions specifically as

to the dispute between ourselves and Competitive Foods. Talking to the general questions, you will see on its terms that we have serious concerns with the legislation as it is currently proposed. I will talk to those, presumably in the course of questioning.

Similarly, as to the specific issue about dispute, it is our opinion, having read general public statements that have been made by Competitive Foods, and also our belief, looking at certain elements of their submissions, that they contain within them allegations of our behaviour which we believe are incorrect. We have put what we consider to be a full and truthful account, or at least a truthful account, of some of the key and more egregious of those—what we would describe as misrepresentations—in our submissions. I am happy to go to those during the course of this hearing.

The DEPUTY CHAIRMAN: Sorry, can I just clarify that? You are making a comment on the submission—

Mr Bryden: No, more specifically as to general comments, commentary and public comments that have been made by Competitive Foods regarding our conduct. The key misrepresentations are set out in our submissions, and I am happy to talk to those.

The DEPUTY CHAIRMAN: Could you just briefly explain why you think the bill acts retrospectively?

Mr Bryden: It has retrospective effect in the sense that it applies to contracts already in existence. In other words, it can apply because it is an express duty of good faith. It can apply to override the terms that are fairly agreed to between the parties and have been in application in one case for up to 20 years. In that case it has a retrospective application.

The DEPUTY CHAIRMAN: Just to clarify, are you saying that it changes your relationship yesterday or it changes your relationship from this point on?

Mr Bryden: It changes the relationship of an agreement that is already in place, and in that respect it is retrospective.

The DEPUTY CHAIRMAN: You are saying it varies the terms of the agreement?

Mr Bryden: Correct.

The DEPUTY CHAIRMAN: But it does not actually act retrospectively.

Mr Bryden: No, I would say that it does act retrospectively, but I would say that it does not look to past conduct—I agree with you on that point. The point I would make is that, because it is an express duty that overrides a contract, the contract could have been entered into many, many years ago. Their party has been freely and happily performing under the terms of the contract and then to be overwritten—in that respect and that respect alone—I would say that it has retrospective application.

The DEPUTY CHAIRMAN: That is common in laws of Australia—for example, industrial laws that must have effect on your business events.

Mr Bryden: I am not aware of the industrial laws; I do not look after that particular section of the business.

The DEPUTY CHAIRMAN: Sure, but all I am asking is: would you agree—and you may not agree—that changes to other laws also have the same impact?

Mr Bryden: I would have to look at the specific laws that you are referring to. As a general proposition, there are certainly laws that impact upon contract. Those laws have been established for a long time. We look at, for instance, the Trade Practices Act, unconscionable conduct, but those propositions have been developed over a long period time, so we are operating in a stable economic environment. They do not operate generally, in my view, to vary contracts.

The DEPUTY CHAIRMAN: But you are not arguing that the sovereign Parliament of Western Australia does not have the right to do that. You are just saying you do not think we should.

Mr Bryden: I think I answered the question to the best of my ability.

The DEPUTY CHAIRMAN: Just conclude on this particular issue: how would you think the Parliament should go about inserting a good faith provision into the franchise relationship?

Mr Bryden: Certainly I think any codification of the common law would be acceptable. In that sense, the common law is very clear that the duty of good faith is in the exercise of the powers conferred under the contract. To me, if the law was to be codified, then it should be made express that the duty is to act in good faith in accordance with the terms and conditions of the contract.

The DEPUTY CHAIRMAN: That was not the question I asked. What I am saying is: let us say the sovereign Parliament of Western Australia decides that we want to insert into the franchising relationship the powers that we are discussing here. Given that there are hundreds and hundreds of contracts on foot, how would we go about doing it without having the retrospective operation that you are objecting to?

Mr Bryden: In the manner that I just suggested. I do believe I answered the question, because what I am saying is that, if the Parliament was to construct a law that said that parties must act in good faith either in accordance with the common law definition, which is substantially what the federal government proposed—which may or may not be acceptable, but I believe I am answering the question—

The DEPUTY CHAIRMAN: What about if we want to do something else? That is all I am asking.

Mr Bryden: That is a matter for you. The second point I would make is that, if you wanted to do something specific, then it should be expressly stated that the parties must act in good faith in accordance with the terms of the contract. I think that is a perfectly acceptable proposition that I have put and would be an option for the Parliament.

The DEPUTY CHAIRMAN: Could you describe the process and costs that Yum! faces in the event that the bill is passed?

Mr Bryden: We set that out in detail both by reference to general statements made by other bodies and also by reference specifically to what we anticipate. If you look at page 3 of our submissions, which you can look at later, you will see that in an apposite issue the Productivity Commission noted, generally speaking —

> There is evidence that significant differences in compliance cost levels exist across jurisdictions. Moreover, there is evidence of jurisdictional differences in areas of regulation where governments have already agreed national consistency is desirable.

So to the general proposition that Western Australia would have a different set of regulatory frameworks for franchising, it is almost undoubted there will be increased costs. Secondly, I would point out that—

The DEPUTY CHAIRMAN: I am just wondering whether you can quantify those costs?

Mr Bryden: It is obviously very difficult to quantify hypothetically, but we can, depending on what version of the legislation is put forward. To that point might I say, the Western Australian legislation differs from the South Australian legislation in a very material respect. That material respect is that there is a novel order, which in our view is particularly egregious, and that is called the renewal order. That order does not exist in South Australia; it only exists in Western Australia. The proposition is, under the renewal order, that we can be compelled indefinitely to enter into new contracts. We have set out what that is. Fundamentally it is a proposition that creates a perpetual contract, a perpetual franchise agreement.

If you look at the consequences of that, references to economic texts on franchising, in particular Blair and Lafontaine, which is included in our submission, and equally, Brickley, Dark and Weisbach—these are both references from the US—make it pretty clear that the consequences of this are that you will get a progressive diminishment of the brand. To give you some context as quantification of that, it has been put on record that businesses of franchisees transfer their multiple of earnings, less depreciation, approximately five to six. That was put on record by the head of our franchise group in the federal inquiry. Our businesses—that is, the franchisor's businesses—trade at a multiple of 14 to 17. The difference, in my opinion, is the intellectual property and the value of the brand. Approximately half of the value of the overall business on top of earnings will be attributable to the brand, and perpetual contracts are noted for diminishment of brand.

We have got specifics. It is difficult for me to go into detail on that, but I would refer to page 9 of our submissions. You will see that we have also set out six areas specifically in terms of cost on page 11. We do not quantify those, but there is a residual value to the brand and eternal value to the contracts, which can be quantified. It is our proposition that, were there to be perpetual franchise agreements, that cost would need to be passed on by way of a higher royalty rate.

Mr P. ABETZ: Where in the bill do you see a perpetual franchise agreement? My understanding is that that is not in the bill. It is simply a provision. The renewal is something that the court may, if it believes it is appropriate to impose that—for example, a franchisee is terminated inappropriately, seeks an injunction—issue a renewal order for three months until the matter is heard in court. Do you have an objection to that type of use of a renewal order?

[10.50 am]

Mr Bryden: That is, in my view, one possible option available to the court, bearing in mind that the bill is crafted more broadly than that. What the bill says, as I recall it, is that the court can order the parties to enter into new contracts on terms that it deems just, having regard to the existing contract. Let me just say that that is a very novel concept; I have not seen it before. In our view it is novel from a global perspective, and we have set out some of the potential models. I have no idea how a court is going to determine what a just provision is; but having regard to the previous contract, presumably a court could order that they enter into a new contract on the old terms. That is one option. Without further clarification, that option is definitely available to the court, and in those circumstances we could see perpetual contracts, or we could see a range that is much less than that; I agree with you on that proposition.

The DEPUTY CHAIRMAN: What is the objection? As you say, the bill is not aimed at that, but what is an objection to a perpetual contract?

Mr Bryden: The objection is that fundamentally, we own and control the brand. The literature that I directed you to earlier makes it very clear. The threat of termination or non-renewal is the primary method by which the franchisor has policy quality and to protect the trademark.

The DEPUTY CHAIRMAN: So what are you trying to protect it from?

Mr Bryden: We are trying to protect it from diminishment at the hands of an individual franchisee.

The DEPUTY CHAIRMAN: What sort of thing are you describing?

Mr Bryden: Effectively, there is a series of possibilities. Let me just step up one level. I am not sure if the entire committee is aware of what our contract is. We have an initial 10-year term and a renewal for 10 years, so we are talking about a 20-year contract; it is a very long-term contract. That is a licence to use the brand at a specified location over that period of time, from which the franchisee must derive whatever economic benefit they would seek to derive. Over that time, what the franchisee does is invest in capital, but that capital is, generally speaking—and, I would say, nearly always—fully depreciated; that is, its value is effectively zero by the end of the licence agreement. That is, in effect, what happens. The specific issue you have over a very long period is that you may have deviations in compliance to standards, whether that be compliance to operational

standards or compliance to asset standards et cetera. Those deviations may not, in isolation, be cause for terminating the franchise, because that is a very harsh consequence. Indeed, the court would scrutinise, over a long-term contract, that the severity of the breach matches the outcome. It is a very harsh consequence to terminate the franchise; it is not easy to do. The point is that if they get to the end of the agreement, and we often do, where, for one reason or another—for instance, an asset action has been delayed—we are in the perfect place, no ifs, buts or whys, to say, "Yes, we will re-grant you a new contract, provided you do an asset upgrade". Equally, in the terms of the contract, because they are highly relational, and I think that is part of the reason why franchising is recognised and treated as a special regulatory case, relationships can sour. Even though the bare bones of compliance can be there, the overall relationship can sour, and do we want to keep investing, growing and developing this business into the future? One will say, "No, we don't", and in fact that is the situation in which we find ourselves with Competitive Foods.

Mr I.C. BLAYNEY: Looking at it the other way, I had a group from the local KFC in my electorate office the other day that said they thought that in a year's time they would all be out of a job. It seemed to me that the store would just be closed, yet anecdotally I think it makes quite a lot of money, and it just did not really make any sense.

Mr Bryden: Let me answer from the perspective of history; I think it is important for everyone to understand this. In 2003 our business notified Competitive Foods that we would not enter into new agreements; we are now in 2011. The first of those expiries took effect in late 2007; the only store that has actually closed is Rockingham. The remainder were transferred because we facilitated a transfer by allowing a hold over, and by allowing a transfer, in one case, to an existing then-employee of Competitive Foods. The remainder of the stores have been very consistent. In 2003 we said, "You will not get new agreements, so you must either sell your stores to another franchisee", and we made an offer as well.

The DEPUTY CHAIRMAN: So you are happy to renew the agreements for those stores, as long as CFAL is not the franchisee?

Mr Bryden: Correct. We allowed certain stores at the end of their tenure to transfer on that basis; we allowed three to transfer on that basis. We were also holding over a number of other stores, so I can say that we have absolutely tried to facilitate the sale or transfer of these businesses. Had the business been sold or transferred, as has been the case with other franchisees who have wanted to exit on their own terms or who have been invited by us to exit, the employees would transfer and would have the same terms and conditions and still be employed. You have to separate out the underlying jobs that have been transferred, but the fundamental reason why the businesses have not transferred, in my opinion, has been because—we have been told this by Competitive Foods—they believe that the law will change in a way that will allow them to continue to operate their agreements, even though their contracts say that they have expired.

The DEPUTY CHAIRMAN: Can I just go to that question about expiry? If you have a retail lease and the lease expires, as long as you keep paying your rent, you stay in the premises. If you have a fixed-term employee and they turn up for work after the end of the fixed term and you continue to pay them, they continue to be an employee. Is there a particular reason, do you think, that a franchise agreement should be different to those types of contracts?

Mr Bryden: I am not familiar with retail leasing; I know that there is a holdover period, but that is not indefinite, so —

The DEPUTY CHAIRMAN: Well, any contract. Are you a lawyer?

Mr Bryden: Yes, I am. The general principle of contract is that it is for a term, and should there be any holdover at the end of it, it is terminable upon reasonable notice. I have no problem with that, and in fact, that is why we give five years' notice of the first agreement; we are now just about at eight years' notice. We certainly take the view that it is not unreasonable to require that reasonable

notice be provided at the end of the contract. That reasonable notice should make clear reference to the length of the contract, so I have no dispute with that at all. Were we to holdover, we always stipulate that there is going to be a notice period when we set that out.

Mr P. ABETZ: If a franchisee has a store with a 20-year contract and it is year 18, if he sells that, obviously the new purchaser has only a two-year window of opportunity. When that transfer takes place, do you then grant a 20-year contract to the new person? How does that work?

Mr Bryden: We have a published policy for the franchisees, and what we say is, "Come to us in the last five years of the agreement at any time, and tell us whether you want to continue in the business or not. We will make a decision whether we want to continue in the business with you, and we will let you know at that point. If we don't want to continue in the business, we will invite you to transfer your businesses, and should you transfer to a new franchisee who is an otherwise suitable franchisee in accordance with our set criteria, and that franchisee does the requisite asset development—either fully upgrading the store or rebuilding it—then we will give that franchisee new paper". That is published policy.

[11.00 am]

Ms A.R. MITCHELL: You argue in your submission that the bill does not contain any provision for mediation. Given that clause 7 of the bill states that the Franchising Code applies, will the mandatory mediation, which is not included in the code, not still be available to franchise participants in Western Australia?

Mr Bryden: We may well just miss that point. If that is your belief, then that is fine. Clearly, there is still the federal code. We would have mediation.

The DEPUTY CHAIRMAN: Again changing direction, on page 12 of your submission you cite a 1995 report on expansion into Iowa.

Mr Bryden: Yes.

The DEPUTY CHAIRMAN: I was just wondering whether Yum! has a more contemporary analysis of these developing issues in the US and Canada.

Mr Bryden: I do not have anything more than that. That was taken from our submissions to the federal inquiry, and that was provided in consultation with the US body. I can probably get something else if it is needed. I think those are historical experiences.

The DEPUTY CHAIRMAN: I am just interested, and the committee is interested, in knowing if there is any other data.

Mr Bryden: I do not have anything. What I should say, and this is a point that everyone should be clear on, is that our US KFC business has a unique contract, and the unique contract is that everywhere else we operate on this—the document I am holding up for members to see. It is a standard international franchising agreement. It comes like this. There are slightly different schedules and those are based usually on the law, or else on agreements with franchise groups. In the US we have a different one. The reason for that is when the good Colonel Harland Sanders set up franchisees back in the 50s, 60s and 70s, he did a lot of it on a handshake. Over time there have been major disputes between the franchisor and the franchisee, and there was a high-profile case recently. What the judge said in the high-profile case was that the agreement is fundamentally unworkable because it essentially gives the franchisees the overarching power to market the brand, but the franchisor continues to own the brand. The judge made a compromise ruling, which said effectively, and quite wisely, "You guys need to sort this out." I think that is the point that we are concerned about here. I know that there is, if you look at the contract, imbalance; I recognise that. But the imbalance is because there needs to be strong safeguards to protect the brand. Then the ameliorating effects of that come from both the law in terms of unconscionable conduct and indeed the implied duty of good faith. And they also come from the fact that the reality is that we only own

the brand. Our franchisees are the face of the brand; they own the stores and they own the physical assets. What tends to happen, and we have got plenty of evidence in our system, is that we do negotiate outcomes. We voluntarily created an advertising cooperative where it is jointly managed by franchisees and us, because the franchisees have the power to say, "Well, we don't like everything you do in marketing." So, you get all these corporate structures emerging. There is more balance than one might immediately perceive from here. We are all for reasonable controls, but we believe that this bill goes a step too far.

The DEPUTY CHAIRMAN: And is that step too far on each element or on specific elements?

Mr Bryden: Maybe I could turn to that before going further. The first issue is the one that I have raised and have a very real concern about, which is the expressed duty that overrides contracts, as opposed to the very clear implied duty that applies. So, currently when we act in good faith, we have still got the contract and around that we have to act in good faith. I would concede, as anyone looking at this law would, that you read the literature and you do a survey of the judgements. Good faith is an illusive concept. I think that one author, Terry, who is a commentator, once described it a little bit like—I do not know if you remember—the movie *The Castle* and "the vibe". It is a little bit like that, and so I do understand and I have some sympathy for the idea that one would seek to kind of get some clarity around that. The challenge is, and it is set out by the ACCC, to simply say that it might be really hard to do. The ACCC wrote in its submission to the federal inquiry —

> Specifically, we note there is a degree of uncertainty about the meaning of a statutory obligation to act in good faith. 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 conflict among franchising participants.

That is from the ACCC. So, there are two specific terms that I have trouble with. I have trouble with fairness. It is the essence of every good entrepreneur to drive a favourable bargain; I think we all know that. What troubles us is if we then have a court saying, "Well, is fairness 50–50?" Every entrepreneur who is successful—whether it be the principal of Competitive Foods, head of The World et cetera—seeks to drive a bargain that favours them.

The DEPUTY CHAIRMAN: Sure.

Mr Bryden: And of course that is what it does. And that is why the courts have been very resistant to that. Again Terry, in his text "Franchising and the Quest for the Holy Grail", says —

> While an intuitively attractive idea, fairness is too abstract an ideal to which to subject contractual parties in the real world. This is probably why it has not received much support beyond its being tacked on the end of sentences … in various judgments.

The reference is in our submission. The other problem I have is "reasonableness" without further qualification of what that means. There is in my view—and it is the view of Peden, Carter and that line of authority, which is a well-regarded contract text, probably the pre-eminent one that there is—a general duty to act reasonably in the discharge of contracts. That is why I say we have got to give reasonable notice and we have got to act reasonably. As we are interpreting what a specific clause means, there is a reasonableness. But as is said by Peden —

> A requirement to satisfy a standard of reasonable behaviour is more demanding than the requirement of good faith. … (T)o require parties to a commercial contract to temper their conduct by reference to reasonable standards of conduct has implications for the fundamental need for certainty in franchise contracting, despite its relational nature.

So, I think these are the two biggest terms. There are other issues, cooperativeness et cetera, but they are in there.

The DEPUTY CHAIRMAN: Your understanding of the bill is that clause 11 would require fair outcomes for the contracting relationship?

Mr Bryden: My understanding of the bill, if I am asked to interpret it as I understand it, is it very simply says that the parties—is it the parties or the franchisor?

Mr P. ABETZ: The parties.

Mr Bryden: Yes, the parties must act honestly, reasonably, fairly and cooperatively in the franchise relationship. Would that not just be every aspect of the relationship, contract and non-contract; everything?

The DEPUTY CHAIRMAN: We previously had evidence from the Retail Traders' Association and their submission was that you could have a capricious outcome for a contract as long as the parties acted with good faith in the negotiations. Is that your reading of the bill?

Mr Bryden: I have not turned my mind to that issue. I think the main point I would say is that there is not a single element of the franchise relationship which is excluded in the definition.

The DEPUTY CHAIRMAN: Sure.

Mr Bryden: So, it could apply to pre-contractual negotiations or the end-of-term relationship. It could apply to breach of contract. It could apply to the very fundamental nature of the contract. For instance, we charge a six per cent royalty. Is that fair?

The DEPUTY CHAIRMAN: Do you believe that the duties provided by this bill are in place of the common law obligations or they sit alongside the common law obligations?

Mr Bryden: I could not give you an expert view, I must say, on the relationship. I do not think the common law is excluded, so one would think that they would be mutual obligations, which could be difficult. And you have that; for instance, it is not that unusual that a party can sue both under legislation and under a statutory outcome, and good lawyers will pick both courses of action and choose whichever one is most favourable to them.

The DEPUTY CHAIRMAN: Do you believe there is a question of double jeopardy in respect of the bill? I know this has been raised a number of times before.

Mr Bryden: Yes. I think the issue is more of complexity. I am used to dealing with other areas of the law where you have multiple frameworks that apply to the same course of action. And what happens is lawyers throw them all into the melting pot, you get big statements of claim and you sue on every single thing. Fundamentally, they generally come down to the same sets of facts and the same principles, but there can be important variances. I think the best answer I can give is I just do not know; and that answer to you is probably troubling.

Mr P. ABETZ: Just changing gear slightly, basically the bill, as I understand it, does two things: one is the obligation to act in good faith.

Mr Bryden: Yes.

Mr P. ABETZ: And it introduces penalties for breaches of the Franchising Code of Conduct.

Mr Bryden: Yes.

Mr P. ABETZ: Do you have any objection to penalties for breaches of the code?

Mr Bryden: It certainly changes the nature of the current regime. It is something that as a general rule I would not put a blanket "no" to penalties. I think the more concerning and troubling aspect for me is that there are some remedies, and novel remedies. I can explain one of them, which is the renewal. I think the injunction clause, while I sort of get it, is troubling. I mean, the injunction clause—that is, if you are a franchisee, you cannot have security for costs orders and things like that—is predicated on a belief that it is going to be small franchisee versus big franchisor. That is just not the case, certainly in our dispute. Competitive Foods is one of the biggest businesses in

Australia. It has one of the biggest private businesses in Australia; and there is no exclusion under the bill for big businesses. My view is that because of the nature of this and the remedies provided, it is most likely to be availed by people with deep pockets who are seeking to use litigation as leverage in a commercial negotiation.

The DEPUTY CHAIRMAN: Sure; could I just come to that? Again it was raised with us by the Retail Traders' Association that even though a court could not order the undertakings, the absence of undertakings would still be considered by the court. Do you have a comment on that?

Mr Bryden: I am sorry, I am not quite following.

The DEPUTY CHAIRMAN: The fact that the court cannot order the franchisee.

Mr Bryden: Okay, in terms of the balance of convenience?

The DEPUTY CHAIRMAN: Yes.

Mr Bryden: That is beyond my technical competence; sorry.

The DEPUTY CHAIRMAN: That is fine; no trouble.

Ms A.R. MITCHELL: I go back to the mediation, if you do not mind.

Mr Bryden: Sure.

Ms A.R. MITCHELL: What experience has Yum! had with the current mediation regime that exists within the code?

Mr Bryden: Unfortunately, we have never had to use it. We have disputes. We resolve them. In the vast majority of cases and in the case of the singular dispute identified in Western Australia, it is probably a bit beyond the scope of the mediation to be perfectly honest. It is kind of not the stuff of mediation but I think it is a great clause. I mean, I am generally in favour of it, but good franchisors, and I put us in that category, tend to listen and they tend to resolve disputes before they get to that level.

The DEPUTY CHAIRMAN: Outside Western Australia how many franchisees do you have?

Mr Bryden: We are an umbrella. There is KFC, which I am representing today, but we also have Pizza Hut as well. There are probably about 300 franchisees in Australia; and globally probably thousands.

The DEPUTY CHAIRMAN: And of those 300, would most of them be multi-store or most of them single?

Mr Bryden: No, it really varies. Pizza Huts are virtually all single-unit operators, low-turnover businesses. In KFC we have everything from single unit right up to Competitive Foods; and our Queensland franchisee, which fundamentally are the major franchisees, or the franchisee for a state and a territory, are very big businesses, big operations.

The DEPUTY CHAIRMAN: Do you have any view about the extraterritoriality of this bill?

Mr Bryden: Yes, only this, and I know it has been hotly debated: firstly, it does appear to be there. It has an extraterritoriality clause.

The DEPUTY CHAIRMAN: Sure.

Mr Bryden: And the bare reading of the extraterritoriality clause does say that for any business that has a connection with a WA franchise business, as I understand. So, it would appear to have implications both for franchisees operating in Western Australia as well as franchisors operating out of Western Australia. But I am sure you have had plenty of debate on that issue.

The DEPUTY CHAIRMAN: You do not make any particular submission on that issue?

Mr Bryden: Clearly, I do not think it is a good set of circumstances for WA franchisors, but I think from our perspective it just goes into the bucket of saying we would really counsel against state-

based franchising laws generally. I mean, I understand if there are specific policy questions that we are happy to participate in those, but we would certainly prefer to participate in the federal environment through COAG.

[11.15 am]

Mr P. ABETZ: In terms of the costs issue, Jim Penman of Jim's franchising and QSR have stated to us that this bill would not require any changes to their franchising agreements. Witnesses in some submissions have indicated —

Mr Bryden: I do not think QSR would have said that.

Mr P. ABETZ: They did.

Mr Bryden: They did—okay.

Mr P. ABETZ: They said we are compliant with the code already, so we do not actually need to change anything. What is your view on that? Would you think that you would need to change any —

Mr Bryden: We anticipate some six outcomes in terms of increased cost.

Mr P. ABETZ: What sort of outcomes, sorry?

Mr Bryden: Six potential increases—so that is set out on page 11. Coming back to my earlier point, firstly, we do not know what the cost will be. We can anticipate that there will be increased cost, but we do not know because we do not know how the bill is going to turn out. One increased cost that I can say the instance this bill is passed, in all likelihood is my company is facing a large and expensive piece of litigation in the Western Australian Supreme Court. That is a cost and that will cost millions of dollars and take up a lot of management time. We will win that case—I am certain of it—but it is probably 10 years down the track. In other words, I think there is a specific and quantifiable cost there. We have set out others. If it were the case that courts got in the habit of ruling perpetual contracts, which is a possibility that we discussed earlier, there is a range of options under the renewal—I call evergreen—contracts, then, yes, there would undoubtedly have to be a transfer, an increased royalty rate, because they would have to pay for the use and utilisation of the brand indefinitely, rather than over a period of 20 years.

Mr P. ABETZ: What is your view? It has been put to us that if this bill is enacted there are penalties for breaches of the code, it would actually create a more certain franchising environment or protection for franchisees; therefore, it would actually enhance investment in franchising in WA because the franchisee knows that if a franchisor really does the wrong thing, even though the franchisee may not have the financial resources to actually seek redress of some sort, the commissioner can actually launch a prosecution and proceed with that.

Mr Bryden: I think there is a confusion there between, I guess, the enabling legislation and the remedies, because the remedy that you are proposing of penalties could equally apply under the existing law and under the existing Trade Practices Act or the existing Fair Trading Act. That does not necessarily increase or decrease certainty. In fact, the problem is that those penalties apply to a new right and remedy, which is fundamentally uncertain, so I do not follow that argument. I think there is a confusion between the two. One is the right or the liability and the other is the outcome. The penalties themselves will not improve the inherent uncertainty of the new duty of good faith.

The DEPUTY CHAIRMAN: In your submissions you have been talking about free-riding by franchisees and franchisee opportunism. I just wonder whether you could give any commentary on how broad you think that is as a problem in the franchise industry.

Mr Bryden: It most certainly happens. You get it with individual franchisees. It tends not to happen with the larger groups because their investment is such that they understand that if they diminish the brand in an individual store, they diminish all of their stores in a particular territory. I can give

specific examples. In New South Wales, we had a franchisee who we could not communicate with—would not respond to our calls, was never in store et cetera. That franchisee simply flat-out refused to launch new products of ours. We did not terminate him straightaway; we actually went through a number of steps, writing to him et cetera, because you take it very seriously. Your last option really is to breach a contact. We do not want to lose good franchisees. Equally, you can imagine that people going into that store had a terrible experience of our brand—KFC; they cannot get the products that they have seen advertised on TV. They do not care whether it is Franchisee Bloggs; all they see is it is KFC and that KFC is terrible, and that affects everybody in the system. That is what franchisee opportunism is. The sense in which it is used in this is in the pure economic sense, which is to say that as a general economic principle, there will be an incentive to the individual to maximise profits in their store at the expense of the collective. Morally, they may choose not to do that, ethically, but we are talking pure economics and that is the sense in which it is used.

The DEPUTY CHAIRMAN: Do you think it is an extensive problem? Do you think it is a widespread issue for franchisors?

Mr Bryden: It certainly happens. I think all you have to do is drive round and look at the variations in various franchise systems' stores, some of which is accounted for by specifics of the cycle of their upgrades et cetera, but it definitely happens. You see variants. If you go into any franchise group, whether it be food, banking, furniture et cetera, there is absolute variance in the quality of service and operations that you receive in those stores. Unfortunately, when consumers pick the lower standard, they often remember the lower standard, so that is the problem.

The DEPUTY CHAIRMAN: Thank you for your evidence before the committee. A transcript of this hearing will be forwarded to you for 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 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, please include a supplementary submission for the committee's consideration when you return your corrected transcript of evidence.

I think we specifically asked whether you have updated US research.

Mr Bryden: Yes, if I can get it —

The DEPUTY CHAIRMAN: If you have any, that would be great.

Mr Bryden: Absolutely, I will put the word out. I thank the members of the committee for their time and the hearing. I really appreciate the opportunity, thank you.

The DEPUTY CHAIRMAN: Thank you very much.

Hearing concluded at 11.21 am