The Franchising Code of Conduct: Does its Coverage Address the Need?

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I. Introductory Comments

We are into franchising regulation again. There have been quite serious attempts at this before[1], there has been some industry specific legislation in the petroleum industry since 1980[2] and there have been a plethora of commentaries and studies which have said a good deal about franchising.[3] There are, however, three background factors which are quite different now to anything which has preceded. The first is that overall franchising legislation is now the law. Previously there have been various sections relating to misleading and unconscionable conduct enacted in the *Trade Practices Act* and amendments to these. Specific franchising legislation had, however, been enacted only in relation to petroleum franchising. Now legislative control covers all franchising, and this term is defined in extraordinarily broad terms.

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1 See, for example, the two *Exposure Draft Franchise Agreement Bills* introduced by the Labor Party in 1986. These Bills were not proceeded with.

2 The *Petroleum Retail Marketing Franchise Act* 1980 (Cth).

3 See *Trade Practices Review Committee* (Swanson Committee), August 1976; *Trade Practices Consultative Committee Report on Small Business and the Trade Practices Act* (Blunt Committee) December 1979; W J Pengilley "Franchising - What Impact: What Problems: What Solutions?" *Report to the Minister for Business and Consumer Affairs, the Hon John Moore*, Monash University Monograph, 1982; the two *Exposure Draft Franchise Agreement Bills* introduced by the Labor Party in 1986 but not proceeded with; *Trade Practices Discussion Paper*, Baker & McKenzie, 1989; *Report of the House of Representatives Standing Committee on Industry, Science and Technology: Small Business in Australia - Challenges, Problems and Opportunities*, January 1990; *Unconscionable Conduct and the Trade Practices Act - A Report by the Trade Practices Commission to the Attorney-General*, July 1991; *Report by the Franchising Task Force to the Minister for Small Business and Customs*, December 1991; *Review of the Franchising Code of Practice*, R Gardini, October 1994; *Finding a Balance towards Fair Trading in Australia - Report by the House of Representatives Standing Committee on Industry, Science and Technology* (The Reid Committee), May 1997; 1998 Amendments to the *Trade Practices Act* enacted pursuant to the Government's "Small Business Package" legislation. In addition to the

The second factor is that there is now no effective political will against franchising legislation or to limit its extensive coverage. Previously opposition to franchising control was quite spirited and there was much debate on technical issues and whether or not draft legislation was "overkill" in many areas. This debate resulted, for example, in the two Labor Party Bills initiated in 1986 being withdrawn - largely because of their technical deficiencies and their perceived "overkill" effect. If anything, however, the Labor Party in opposition is now more anxious to control franchising, and to extend this control, than is the Liberal-National Coalition Government. For its part, the Liberal-National Coalition apparently now believes that all those criticisms which it previously made of the Labor Party Bills are no longer relevant. Those commercial problems so rightly highlighted by Coalition comments on the draft 1986 Bills have disappeared now that the Coalition sits on the other side of the Speaker's chair. So, each side is an enthusiast for the legislation. Each has nailed its colours to the small business mast and each sees small business votes in franchising control.

The third factor is that the method of controlling franchising is not to be by way of an Act of Parliament. It has never previously been suggested that franchising should be controlled other than by legislative enactment. The method of control set up by the 1998 legislation, however, has been to amend the *Trade Practices Act* so that codes of conduct can be prescribed under it. The *Franchising Code of Conduct* is one such prescribed code.[4] A code of conduct [known as "The Oilcode"] is to be prescribed for petrol resellers but, at the date of writing, has not been so prescribed.

The Minister has assured me in writing that there are no plans to add

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above reports which specifically comment on franchising legislation, there have been a significant number of reports and commentaries on the need to extend legislative protection in relation to unconscionable or unfair conduct. Much of the need for the extension of this protection has been seen to be necessary to protect small business and franchisees: see *Trade Practices Act - Proposals for Change*, Green Paper issued by the Attorney- General, February 1984; *Trade Practices Revision Act* 1986; *House of Representatives Standing Committee on Legal and Constitutional Affairs - Mergers, Takeovers and Monopolies Report* (1989) (recommending against Trade Practices Commission view that unconscionable conduct prohibitions should be extended to commercial transactions); *Unconscionable Conduct and the Trade Practices Act: Possible extension to cover commercial transactions - Report of the Trade Practices Commission to the Attorney-General* (July 1991); *Report by the Senate Standing Committee on Legal and Constitutional Affairs: Adequacy of Existing Legislative Controls* (December 1991); *Report by Working Party to Minister for Small Business on the need to amend Section 51AA* (February 1995 with Supplementary Report May 1995); Better Business Conduct Discussion Paper, Department of Industry, Science and Technology (October 1995); *Trade Practices Amendment (Better Business Conduct) Bill* (not enacted); Amendments to the *Trade Practices Act* 1998 enacted pursuant to the Government's "Small Business Package" legislation.

4 A new PART IVB of the *Trade Practices Act* entitled "Industry Codes" is to be enacted. An industry code means a code regulating the conduct of participants towards other participants in the industry or towards consumers in the industry. A "consumer", in relation to an industry, means "a person to whom goods or services are or may be supplied by participants in the industry". Section 51ACA(3) declares franchising to be an industry and franchisors and franchisees to be participants in the industry of franchising whether or not they are also participants in another industry. Whether a code is voluntary or mandatory is determined by regulation made under s51AE of the Act. This section allows regulations to prescribe the status of codes and, in relation to

to the number of prescribed codes. Perhaps there are no such present plans but this does not mean, of course, that such codes will not come forth in multitudes in the future.

Legislation by executive fiat no doubt solves many of the problems which might be raised in a Parliamentary Debate relating to franchising legislation.[5] Executive fiat also, no doubt, solves the difficulty of having to explain and defend what is probably the most basic and vexed question in relation to franchising legislation - what is a franchise?

All of these practical issues aside, the changing of vast tracts of commercial law by executive fiat must be of concern to those who still believe that it should be Parliament which legislates basic changes to our laws and not Ministers who proclaim them, without debate, in the Government Gazette.

Two things certainly follow from the Executive proclamation legislative track. Firstly, the Government has been able to display a very high-handed attitude in relation to franchising control. For example, the "public consultation process" in relation to the final draft definition of a franchise lasted only 11 working days (assuming that you were eagle eyed and organised enough to obtain the Draft Code on the day the Government released it).[6] The final definition of a franchise was promulgated in law contemporaneously with its release. Secondly, no doubt the Code,

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voluntary codes, to prescribe:

> "the method by which a corporation agrees to be bound by the code and the method by which it ceases to be bound (by reference to provisions of the code or otherwise)".

Section 51AD(1) provides that:

> "A corporation must not, in trade or commerce, contravene an applicable industry code."

Section 51AD(2) defines "an applicable industry code". It means, in relation to a corporation that is a participant in an industry:

> "(a) the prescribed provisions of any mandatory industry code relating to the industry; and
> (b) the prescribed provisions of any voluntary industry code that binds the corporation."

The Australian Competition and Consumer Commission is required to keep a register of notices by which persons have agreed to be bound by a voluntary code.

The remedies in the case of a breach of PART IVB will be damages, injunctions, corrective advertising and "other orders" under s87 of the *Trade Practices Act*. A breach of the new PART IVB will not be a criminal offence.

The Franchising Code does not require any further legislation in order to be legally binding. It has simply been proclaimed as a mandatory code under the *Trade Practices Act*. The Minister for Workplace Relations and Small Business (Mr Reith) has advised the writer by letter (18 December 1997) that: "the amendments to the TPA are not intended to be used in an indiscriminate way ..." and that he does "not envisage that a large number of industry codes need to be prescribed under the new provisions". An "Oilcode" is contemplated for the petroleum industry. No doubt it will become law in the same way as did the Franchising Code.

[5] If any robust Parliamentary Debate should arise. As noted in the text, the Opposition seems even keener than the Government for franchising control.

[6] The last draft of the Code was released on 7 April 1998. Comments were required by 24 April 1998. This is 17 days. However, the Easter break and weekend period within these dates meant that there were only 11 working days for parties to collate and put representations (assuming a state of perfect knowledge in that a member of the public was aware

especially in relation to the important question of the definition of a franchise, will be able to be amended in the same unsatisfactory manner in which it was enacted i.e. without any real consultation or discussion. This leaves us all at the considerable mercy of the various bureaucratic swings or roundabouts in vogue at any particular point in time.

For all of the forests we have destroyed in compiling the various reports on franchising which we have[7], we have not progressed very far down the track in dealing with the problem of franchising regulation in a dispassionate manner. There has been much activity. However, I query whether there has been much, if any, progress. This is especially so in assessing the need for legislative coverage of franchising and, if such need exists, defining with precision what is to be covered. It is this need, and the issue of defining the extent of coverage to address that need, which is the subject of this paper.

II. How Much Franchising is there in Australia?

How much franchising is there in Australia? The short answer is that there is a lot. How much there is depends upon how you define a franchise - a very basic issue and one to which we return later.

Most studies on the amount of franchising in Australia are not specific as to what they include within their definition of a franchise or they at least have a somewhat blurred definition of the term. Really, however, it does not matter. By whatever yardstick you define a franchise, there is a lot of franchising in Australia.

The 1997 *Reid Committee Report*[8] cited a 1994 Australian Bureau of Statistics survey of Australian franchising which said in relation to franchising in Australia that there were 555 franchise systems, 26,000 franchisees, with a total turnover 1993-1994 $42.7 billion, 279,000 persons employed, a 67% growth in the number of business outlets operated by franchisees since 1991 (an annual growth of 14%), and that 18% of home grown franchise systems had been exported.[9]

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that the code had been released and was able to obtain a copy). This makes a mockery of any so-called "public consultation". Notwithstanding this, Minister Reith assures us in his Foreword to the *Franchising Code of Conduct* that the Franchising Council had "consulted widely with all sectors of franchising". In view of this, it is strange to see that one body which has complained about lack of consultation is The Franchise Council of Australia (see letter to Law Society of New South Wales Journal 11 May 1998 and Press Release by Council entitled "Call for Action".) There were a number of drafts which were circulated from about October 1997 but these were made available on a strictly confidential basis and only to selected groups.

7 See n3.

8 Report by the House of Representatives Standing Committee on Industry, Science and Technology: May 1997 (The Hon Bruce Reid, Chairman) entitled *Finding a balance towards fair trading in Australia.*

9 Above at p85. See also comments from Professor Terry following.

Professor Andrew Terry, Director of the Centre for Franchising Studies at the University of New South Wales stated in evidence to the *Reid Committee* that Australia had twice as many franchising systems per head as the United States though 65% of Australian franchise systems had fewer than 10 franchisees. Franchising is obviously a huge activity in the United States[10] so, if Professor Terry is correct in what he says, it is obviously also huge in Australia.

As a matter of pragmatic observation, it is clear that franchising, by whatever definition is considered appropriate, is a pervasive method of doing business in Australia. We are all familiar with names such as Dymocks, Pizza Hut, Tandy, Hertz, Holiday Inn, Kentucky Fried Chicken, McDonald's and the like. Franchising is found in industries as diverse as quick printing, lighting shops, funeral parlours, day care schools, home tuning services and computer stores.

Franchising is not, however, an industry. It is a method of doing business. It thus transcends particular industries.[11] One of the problems in regulating franchising, therefore, is that a problem in one industry which involves franchising is not necessarily a problem in another.

Leaving aside for the moment the definitional niceties involved in "what is a franchise", the marketing rationale of a successful franchise system is that it combines a franchisor's reputation, trade mark, systems, advice and proven success with the franchisee's small business ethic and entrepreneurship. The franchisee has the "get up and go" but cannot afford the considerable research and investment in the expertise gained by the franchisor over the years. In a sense, the big and the small have need of each other. A successful franchise system combines the needs of each.

It can be argued that society benefits from successful franchise operations. Through decreased economic concentration, a multitude of small businesses replace the alternative of the corporate monolith. Thus it can

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[10] There are many estimates of the amount of franchising activity in the United States. However, by whatever standard of evaluation one uses, the growth of franchising has been dynamic. According to the US House of Representatives Committee on Small Business, there were fewer than 100 companies in the United States using franchising as a method of doing business in 1950. By the end of that decade, there were more than 900 companies with franchising operations and some 200,000 franchised outlets. In the 1960s; 1970s and 1980s, the numbers of franchisors and franchisees continued to increase. By 1990, the number of franchisors had reached about 3,000 and the number of franchised outlets had reached 521,000 with a sales volume of $US715 billion.

The US Department of Commerce has called franchising "the wave of the future". Time Magazine has said that the year 2,000 will herald in franchising as "the primary way of doing business" in America. According to a study done by the Naisbitt Group in the United States, franchise sales will, by the year 2000, constitute one half of all retail sales.

See Commentary in WL Lewis: "Franchises: Dollars and Sense" (Kendall Hunt Publishing Co 1991) p4.

An exact quantification of the amount of franchising is quite peripheral to the main points to be made in this paper. An examination of any study done on the subject shows that there is "a lot" of franchising activity and it is a quite basic method of marketing a wide variety of goods and services.

[11] See n13 as to the inclusion of "franchising" in the *Trade Practices Act* as an "industry" in light of this.

be argued that franchising is the most feasible alternative to vertical integration in many areas of the economy and that, therefore, franchising may be one of the most promising hopes for the preservation of independent small business persons in our society today.

III. Some Conclusions from the Above as to the Philosophy of Franchising Legislation

From the above, I would conclude that some of the fairly obvious objectives of a franchising law should be:

1. that no franchising law should inhibit or stultify the growth of franchising as a method of marketing. Neither should franchising law inhibit or stultify the growth of other forms of business. This can happen, for example, if a method of conducting business is unreasonably classified as a "franchise" and subjected to regulation as such;
2. that any franchising law should be aimed only at making franchising fairer or at redressing possible power imbalances. A franchising law should be confined to this object;
3. that any franchising law should operate only where unfairness or power imbalance is found, and not otherwise;
4. that if there is a perceived deficiency in a particular industry but not in others, legislative control should not be "broad brush" but should aim at resolution of the problem on an industry specific basis;
5. no franchising regulation should be greater than that required to remedy an identified problem. In other words, franchising should not be subjected to "overkill" regulation; and
6. there is no need for further legislation if present legislation adequately deals with any perceived problem.

The 1997 *Reid Committee* would appear to endorse the above views although it does not put its conclusions in the same terms. It concludes:

1. that there is no doubt that franchising relationships are open to abuse because franchisors occupy a co-ordinating position within the system and this provides them with a significant level of market power in relation to any particular franchisee. This power is compounded when the franchisor is a major corporation. Presumably, therefore, the *Reid Committee* would not regard franchise laws as being necessary where there is no power position involved.

   A supplier of a product may well have a trade marked article and require the product to be marketed in accordance with a particular marketing plan. But this does not necessarily involve a power imbalance situation if, for example, the supplier is not a major one or

if the purchaser also markets competing products. Traditionally, power imbalances occur in relation to a purchaser who is dependent upon one supplier and the purchaser's business is publicly identified with the trade mark of the supplying company. The question of power imbalance is discussed later in this paper.

2. "The Committee believes that widespread abuses are occurring in practice."

   The Committee reaches this conclusion on complaints made to it and to other enquiries. The Committee presumably would believe that franchising legislation should be addressed only to those areas where widespread abuses are involved.

Presumably also the *Reid Committee* would agree that there is no case for regulation greater than that required to remedy a perceived deficiency and that there is no need for further legislation if present legislation deals with any perceived problem.

The question, therefore, has to be asked, and answered, whether the 1998 franchising regulation carries into effect what the Committee found to merit legal control; whether it does this efficiently or not; and whether or not the legislation is trespassing in pastures in which it should not tread.

Crucial to answering this question is an evaluation of the definition of "franchise" contained in the *Franchising Code of Conduct*.

IV. What is Franchising?

We all intuitively know what we mean by franchising. Trying to define it in legal terms is, however, a very different task. For the moment, we will treat the matter conceptually in terms of function.

The *Reid Committee* adopted the usual classification of franchising functions and concluded that commonly franchising is seen to be divided into one of, or a combination of:

product franchising, where a distributor supplies the product of a manufacturer, often with exclusive right to sell within a specific market (common with motor vehicles and petrol);

business format franchising, where a unique system of doing business is undertaken in a controlled manner usually with a trade name, trade mark, or specified decor (for example, restaurants, real estate and motels); and

manufacturing franchising, where an essential ingredient or technical information is supplied (common in the soft drink industry).[12]

It is clear enough that franchising transcends particular industries.[13] It

also transcends particular legal relationships as they are currently known and taught. Thus franchising partakes of some aspects of legal relationships of contract, agency and employment law; licensing law; restrictive trade practices law; trade marks law; and the law of misleading or deceptive conduct, unfair marketing and unconscionable conduct. Yet none of these areas of law encompasses franchising in the same way as they do other commercial relationships. For this reason our common law precedent system is singularly uncomfortable in dealing with a marketing system which does not fit snugly within the better known relationships upon which our law has been built.

The *Reid Committee* commented that:

> "Franchising has existed as a business system for many years. The first phase in the development of this system began in the United States with the creation and expansion of the automobile and oil industry franchising networks. These networks were established worldwide, proving the success of the system. Franchising rapidly expanded in the 1950s and 1960s with the development of the concept of business format franchising, typified by the growth in fast food retailing."[14]

I suppose no-one can argue with the above as a generality. However,

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[12] Above at n8 p84. The same definition was used by the Swanson Committee (n67) in 1976. It should be immediately noted in relation to this definition of franchising that, even if it is accepted and even if a need to regulate franchising conduct is found, it does not follow that all relationships coming within the definition need regulation. Not all, perhaps not even a majority, of relationships fitting the above definition have power imbalances - the issue found by the Reid Committee to be the main rationale for franchising regulation. As is noted later, the definition of franchising in the Franchising Code is extremely wide. At least one of the reasons for this would appear to be that it was thought that all relationships coming within the above definition require regulation rather than the next step being taken to ascertain which types of relationships coming within the above definition involve such power imbalances as to merit regulation.

The definition in the *Franchising Code of Conduct* appears to be modelled on a franchise definition suggested by the Swanson Committee. There are, however, vital differences - see no.70.

[13] Because franchising is a method of doing business rather than a particular industry, it must be doubtful if franchising is an industry which can be validly controlled under general legislative provisions covering "Industry Codes of Conduct". In decisions such as *Jumbunna Coal Mine No Liability v Victorian Coal Miners Association* (1908) 6 CLR 309 (see especially Isaacs J at p370) and *Federated Engine Drivers Association of Australia v BHP* (1911) 12 CLR 409, the High Court held that the word "industry" does not mean a general calling but a collective enterprise involving employers and employees. Dictionary definitions indicate that an industry is "a particular branch of trade or manufacture e.g. the steel industry" (Macquarie Dictionary).

To overcome the possibility of a code regulating franchising being held invalid because it is not an "industry code", the 1998 amendments to the *Trade Practices Act* provide:

"To avoid doubt, it is declared that:

(a) franchising is an industry for purposes of this PART; and

(b) franchisors and franchisees are participants in the industry of franchising whether or not they are also participants in any other industry" (s51ACA(3)).

[14] n8 p84. The Reid Committee apparently regards any right to sell a product as a franchise. Thus it said that GMH "franchised" dealers "in that they are granted the right to sell the product of a particular manufacturer" n8 p98.

franchising certainly existed prior to the automobile and oil industries. One learned United States author claims that franchising began over a century ago when brewers licensed beer gardens for distribution purposes.[15] Yet another claims that franchising's roots can be traced to 1851 when Isaac Singer accepted fees from independent salesmen for the right to sell his sewing machines within specific geographic territories.[16] All agree, however, that the real surge in franchising came in the boom years following World War II. Some have put this down to the new highways then built and the increasing number of automobiles then being produced. With the mushrooming numbers of automobiles came other mushrooms in the form of Burger King, Kentucky Fried Chicken, Dunkin Donuts and McDonald's.

It is perhaps ironic, in view of the fact that so many ills are seen from time to time in franchising, to realise that the word *"franchise"* comes from the French word *"franchir"* which means *"freedom, exemption from servitude"*. Hence franchising's appeal to people who want to "be their own boss".[17] Further, of course, whatever the criticisms of franchising, it is obvious enough that it is a highly successful method of marketing and one with a well-proven and impressive track record. Ideally, a franchise arrangement is the crossroad where the spirits of the entrepreneur and the independent business person meet. Certainly legislation which unreasonably inhibits franchising is not one based on economic logic.

Conceptually we can see in franchising a system of producing goods and services in which one organisation (the franchisor) grants the right to produce, sell or use a developed product or service to another party (the franchisee). Beyond this generality it is, in broad concept, very hard to go. No two jurisdictions have the same definition of a franchise for purposes of legislative regulation. As one learned American writer in the franchising area states:

> *"... there is no generally accepted definition of franchising in court decisions, regulation or legislation. Further, any definition would fail to include many functions inherent in the system, as well as its potential for abuse ...".*[18]

The *Reid Committee's* 1997 Report adopted a "crash through" approach to the problem of defining a franchise, commenting that "enough time has already been lost". Therefore, it said that legislation should be enacted immediately.

Perhaps the major problem in the 1998 Australian franchising regulation is the definition of what constitutes a franchise agreement for

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[15] H Brown: *Franchising Realities and Remedies* (Harold Brown 1973) p1.

[16] WL Lewis: *Franchises: Dollars and Sense* (Kendall Hunt Publishing Company 1991) p4. This historical conclusion seems to be based on the view that the right to sell a product in a particular area is a franchise.

[17] n16 p3.

[18] n15 p1

purposes of regulatory control. The Government has undoubtedly embraced the "crash through" approach to the problem suggested by the Reid Committee. Indeed, there is not to be any legislation. The whole regulatory process has been completed in an 11 day public consultation period followed not by Parliamentary debate but by promulgation of a regulation.[19] Admittedly there were various drafts made available to interested parties from about October 1997. These, however, were hardly aimed at encouraging debate. They were made available on a strictly confidential basis and only to selected parties.

The *Reid Committee* failed in what I see to have been one of its major tasks. It failed to specify and define the type of franchising conduct meriting legislative control. It is simply not good enough to brush aside the substantial franchising definitional problem by the comment made in the *Reid Committee*'s Report that:

> "... definitional problems are associated with almost all legislation. Given the weight of international precedent, the Committee believes these definitional problems could be overcome".[20]

Certainly, there is a real possibility of at least learning from international precedent in a bid to do better. But 11 days is hardly enough time to have any meaningful discourse on such a complex subject. The Minister, however, disagrees. In his foreword to the *Franchising Code of Conduct* Minister Reith assures us that the Franchising Council set up under the Code "has consulted widely with all sections of franchising to ensure the Code addresses the issues in the most appropriate manner".

On the assumption that the Minister is correct and that consultation has been made "widely" (quite contrary, one would think, to the short 11 day period available for public input), it is sad that the definitional question of a franchise has been so badly drafted and has such apparent mixed objectives. To the extent that there is international precedent as to a definition of that form of franchising requiring legislative co ntrol, we appear, unfortunately, not to have learnt from it. The Government cites no such precedent for its definition. Indeed, we are left completely in the dark as to the source of the Code's definition of a franchise. This definition is not based on, and is totally different from, all international precedents of which I am aware. It is a totally Australian product. Regrettably, as is argued in this paper, it is not one of which we should be particularly proud.

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[19] As to this "consultative process" see n6. As to the method by which the Franchising Code is to become the law see n4. In a letter to the writer dated 1 June 1998, Small Business Minister, Peter Reith, justified the regulatory, rather than the legislative path approach as:

"entirely consistent with modern regulatory practice. Prescribed codes provide for flexible, efficient and responsive regulation. The use of prescribed codes provides a way to clothe more general legislative requirements ... with industry specific meaning".

[20] n8 p118.

V. Semantics: Where Franchising Loses a lot of Cred

The cool insights of cerebral man are, of course, indispensable to social progress. But they don't make revolutions, even intellectual ones. It is more likely to be rhetoric which motivates to action. In the world of rhetoric, franchising loses out very badly.

The reason why the writer was asked in 1982 to advise the Minister for Business and Consumer Affairs on Franchising[21] was outrage at the time relating to two highly publicised "franchising fraud" cases. Both were cases brought by the Trade Practices Commission. In both, the judges hearing the cases made most scathing remarks about the franchising fraud involved. Politicians were vociferous about the evils of franchising. The public image of franchising was at rock bottom. At the time, franchising and pyramid selling were commonly referred to in the same breath as equally undesirable ways in which to conduct business.

In the first of these cases, *Casnot*,[22] the advertisement involved was for a home operated business. On the Confucian principle that one picture is worth a thousand words, the advertisements involved in this case are set out in **Attachment "A"** to this paper. Casnot Pty Ltd said that it would supply certain equipment and drum up business for those investing with it. Keely J in his judgment referred to Casnot's operation as involving "franchisees". In his judgment, his Honour said that:

> "... The defendant, as part of a deliberate course of conduct over a period of years, made misleading statements both in the newspapers and over the radio. It also made them in discussions with each of the ***franchisees*** referred to in the information ... It is plain that the ***franchisees*** were influenced by those misleading statements in considering whether to enter into contracts with the defendant and were led to invest both their time and money in the defendant's business activity. The amounts of money paid to the defendant by them were $6,120, $7,120 and $4,450 ... respectively."

The second of the cases was *Colourshot*.[23] In *Colourshot*, the advertisement involved was for a position as a Colourshot agent. The advertisement is set out at **Attachment "B"** to this paper. A Colourshot agent was to act as a collection point for colour film to be processed. Smithers J gave

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[21] The writer's advice to the Minister was reformatted, with Ministerial consent, and published as a Monograph by Monash University - see W J Pengilley: "Franchising - What Impact: What Problems: What Solutions?": *Report to the Minister for Business and Consumer Affairs*, The Hon. John Moore (Monash University Monograph 1982).

[22] *O'Dea v Casnot* 1981 ATPR ¶ 40-198. It should be noted that, at this time, the Trade Practices Commission had to institute proceedings by way of a private information. John O'Dea was an officer of the Trade Practices Commission and it was the Commission which instituted the proceedings.

[23] *Ducret v Colourshot Pty Ltd* 1981 ATPR ¶ 40-196. This case, too, was brought by the Trade Practices Commission. Alan Ducret was an officer of the Trade Practices Commission (see generally n22).

judgment in the following terms:

> "These proceedings arise out of a course of systematic, heartless and fraudulent exploitation by the defendants of persons of modest means in which the victims paid thousands of dollars to the defendant company for worthless contracts, were caused to incur expenses in performing unrewarding and onerous work, all lost their money and some were left with a load of debt which will be a heavy burden for years ahead.
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> ... On the evidence it is clear that [the income statements] were quite false. The company could at no stage be said to be an established business and advertising to induce persons to deposit their exposed films with the company's depots was quite insufficient to produce the intake required. Television and radio advertisements were not undertaken. The experience of ***franchisees*** from the commencement was one of complete frustration, disappointment and disillusionment. The evidence shows that of the more than seventy ***franchisees*** the most successful of all, one James, earned less than $60 in every week of his ***franchise***. One earned nothing at all. Others earned practically nothing. Most had maximum earnings of around $20. All of these ***franchisees*** had car expenses averaging about $200 per month and had to devote themselves for the greater part of five days a week calling at depots. They travelled daily for quite long distances up to about 200 miles on five days each week to pick up a trivial number of films, losing money every day. They did this because in most **franchise contracts** there was an agreement by the company to buy back 'the delivery run' after six months if the **franchisee** had faithfully fulfilled the terms of the contract. Several of the **franchisees** concerned in these prosecutions sought to be brought out, but without success, and in the closing months of 1979 the company had no premises, no telephone and was not to be found.
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> ... From the eight persons to whom these proceedings relate, the company received $53,500. It is clear that the **franchises** were not only valueless but involved the **franchisees** in months of work and substantial travelling expenses. From the accounts of the company, it is clear that for four months ending June 1979 its gross profit on developing and processing film was $162. Its overhead expenses were $99,219. Its only real income was from the sale of **franchises** which showed a profit of $179,593 after the cost of commissions to salesmen and repurchases. The gross proceeds from the sale of **franchises** was $284,000. At approximately $7,500 each this represented the sale of 30 **franchises**."

Neither *Casnot* nor *Colourshot* was a franchise in the sense in which the franchising industry would understand the term. *Casnot* was simply a fraudulent home operated business promotion. *Colourshot* was the grant of an agency to collect film in a certain area. Neither involved the concept of an ongoing relationship under a trade name or symbol and the identification of the franchisee's business as being linked with that of the franchisor. *Casnot* was an invitation to invest money. *Colourshot* was, at best, the grant of a delivery run. Both could be described as "franchises" only if a franchise is defined as any grant of a right to conduct business or any invitation to invest money in a business. Even the staunchest advocates of franchising control do not, as far as I am aware, go to this definitional extreme in

asserting the need for franchising regulation. To argue that *Casnot* and *Colourshot* are franchises, and need regulation as such, is to argue that every business, simply because it involves a business contract, needs special legislative protection. The industry that would need regulation on this basis would be "the business industry" not "the franchising industry". Unfortunately, because of the terminology used by lawyers and the presiding judges in *Casnot* and *Colourshot*, the two were equated in the minds of many.

To the extent that a demand has grown for general franchising control because of cases such as *Casnot* and *Colourshot*, this demand is misplaced. Clearly enough Casnot and Colourshot should be called to account. But, of course, they were both called to account under the *Trade Practices Act*. Both were successfully prosecuted under s59(2) of the Act which makes it a criminal offence (and also provides a damages remedy) for a corporation to make a representation which is misleading in a material particular as to the profitability or risk of participation in a business activity requiring the performance of work or the investment of money.

It seems a huge overkill to regard virtually any person offering some form of territorial exclusivity in connection with trade or commerce to be a franchise. Similarly, all business invitations cannot be regarded as franchises simply to appease the indignation which many felt as a result of the *Casnot* and *Colourshot* cases. Even more is this so when the misrepresentations to be guarded against are already well covered by other sections of the *Trade Practices Act*. Further, the *Reid Committee* itself seems to believe that legislation should cover only franchise arrangements in which a franchisor has a significant amount of market power in relation to the franchisee and particularly those arrangements where the franchisor is a major corporation.

Much as we may deplore the conduct of Casnot and Colourshot, they were not significant corporations wielding significant market power. They were con men. Four things can be said of con men:

1. No doubt they will continue to surface from time to time. No legislation will completely wipe them out.
2. Their capacity to deceive has nothing to do with franchising any more than it has to do with any other form of business relationship.
3. Even with the most stringent franchising control, some con men will continue to trap the innocent. The representations in *Casnot* and *Colourshot* were blatantly untrue. Are such persons at all likely to comply with disclosure legislation? Probably they will simply ignore it. Even if they do issue pieces of paper pursuant to such legislation, why would the statements made in them be more likely to be true than the representations made elsewhere?; and
4. Their confidence trick activities are more than catered for by the provisions of the *Trade Practices Act* under which both Casnot and Colourshot were successfully prosecuted.

I instance *Casnot* and *Colourshot* to demonstrate that inappropriate

semantic use of the term "franchise" has certainly done the public image of franchising no good at all. We should all attempt to use the word with greater precision than is currently done. The use of the term "franchise" in each of these cases was the terminology of lawyers and judges and did not reflect the realities of the transactions involved.[24]

There seems no end of persons prepared to attack franchising in the name of reformation. At the time of writing, the press is claiming that high class prostitutes working in Sydney are working for a Madame Fleiss Agency - described as a franchise inspired by the former United States madam to the stars, Heidi Fleiss.[25] No doubt the next attack on franchising will be from moralists demanding that franchises be morally controlled and that franchises not be permitted at all in certain industries.

VI. Why do We get Our Knickers in a Knot Over Franchising?

The common law tradition is that "the law will not come between a fool and his bargain". Superimposed on this tradition, we now have a wide variety of statutory remedies which protect parties from the consequences of being misled or deceived,[26] and which protect parties from the effects of unconscionable conduct.[27] These unconscionable conduct provisions have recently been strengthened by Government as part of its "small business package".[28] Contracts may be upset on the basis that they constitute unconscionable business conduct after a consideration of a number of factors including a supplier's failure to disclose risks involved in its future conduct and the extent to which

[24] From the advertisements set out in **Attachments "A"** and **"B"**, it is clear that there is no reference at all to a franchise and one could not read a franchising relationship into what was being advertised. So far as the writer has been able to ascertain, the parties themselves did not use the expression "franchise" at all in *Colourshot* (n23). Justice Smithers used the term saying in his judgment that he would call the arrangements franchises "because (Colourshot) did not just engage (the parties) as agents or employees". In *Casnot* (n22), the advertisements did not use the term "franchise" in promotions but it appears that the parties did informally use the term "franchise" in conversation to describe the grant of a territorial area. Because the word "franchise" carries with it a certain mystique there may be something to be said for including in any definition of a franchise any agreement which purports to be a franchise. If, however, *Casnot* and *Colourshot* are regarded as franchisees under franchising legislation, any invitation to invest in a business and any grant of a territorial distribution area would be a franchise. To this writer, this seems to be an absurd proposition. Any misleading representations in relation to such matters can, in any event, be dealt with under other sections of the *Trade Practices Act*.

[25] "Will that be on Amex, Sir?", *Sunday Life - Sun Herald* 31 May 1998 (emphasis added).

[26] *Trade Practices Act* s52 (replicated in the *Fair Trading Acts* of the various States and Territories). The impact of this provision on trade and commerce is a separate study in itself which will not be attempted here. The short conclusion is that this impact has been immense.

[27] *Trade Practices Act* ss51AA and 51AB.

[28] In 1998, amendments to the *Trade Practices Act* introduced a new s51AC. In short, this section covers unconscionable conduct in business transactions. In short terms, a business transaction is one involving the supply of goods or services under the price of $1,000,000. The court may upset a business transaction on the basis that it is

the supplier and business consumer may not have acted in good faith in reaching their agreement.[29] As we have seen in relation to *Casnot* and *Colourshot*[30], s59 of the *Trade Practices Act* prohibits misleading representations in relation to business activities requiring the performance of work or the investment of moneys in a business activity and there have been plenty of cases brought under it.[31] Section 51A of the *Trade Practices Act* prevents a representation in relation to a future matter which is not based on reasonable grounds, the onus of proof of reasonableness being on the representor.

Given this collage of legislative protections, all of which apply equally to franchising, as to all commercial transactions, one has to ask why further specific legislation relating to franchising is needed at all.

There are, therefore, those who forcefully argue that the "do nothing" option is too easily rejected and that the present law adequately covers franchising transactions. Whatever one's views as to the merits of this, clearly those arguing for such an approach are not currently in the philosophical ascendancy. What, therefore, is it that many see as necessitating franchise specific legislation?

In some cases, there is no doubt that political imperatives are satisfied purely because politicians want to be seen to be "doing something" and it is irrelevant what that "something" is. However, we must assume, some perhaps may say contrary to reality, that the desire to legislate for franchising is based upon somewhat more rational grounds than this perceived political imperative.

The source document for the current demand for franchising legislation is the 1997 *Reid Committee Report*[32]. The *Reid Committee* instanced a variety of problems in franchising relationships in general and in motor dealership relationships in particular.

These problems can be summarised in the table following (next page):

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unconscionable after considering a wide range of factors. Some of these factors are a failure to disclose risks involved in the supplier's future conduct and the extent to which the supplier and the business consumer acted in good faith.

29 n28.

30 *Casnot* see n22 and commentary in **PART V** of text. *Colourshot* see n23 and commentary in **PART V** of text.

31 A wide variety of prosecutions have been launched under s59. See, for example, *Wilde v Menville Pty Ltd* (1981) ATPR ¶ 40-195 (sale of trucks promising future employment); *Colourshot* n23; *Casnot* n22; *Crossan v Commons* (1985) ATPR ¶ 40-542 (detergents etc business); *Reardon v Aquajet Holdings (SA) Pty Ltd* (1982) ATPR ¶ 40-32 (carpet cleaning machine manufacturer selling to persons answering advertisements; grossly inflated prospective earnings); *Jones v Glen Houn Holdings Pty Ltd* (1985) ATPR ¶ 40-604; *Geale v Glen Houn Holdings Pty Ltd* (1985) ATPR ¶ 40-615 (video businesses: misrepresentations as to expected returns); *Porter v Audio Visual Promotions Pty Ltd* (1985) ATPR ¶ 40-547 (company represented as a "million dollar company" involving investment of $20,000); *Bateman* v *Slatyer* (1987) ATPR ¶ 40-762 (franchisees induced to enter a franchise by misleading representations as to turnover and site selection); *Burnett* v *Big Al's Sandwich Joint* (1982) ATPR ¶ 40-279 (proceedings akin to s59 proceedings brought under s88F of the *Industrial Arbitration Act* (NSW)); *Walter* v *Viney* (1982) ATPR ¶ 40-301 (damages claim against directors for misrepresentation in relation to lease of a concrete truck and profits from this); *TPC* v *Farrow* (1990) ATPR ¶ 41-018 (investment and distributorships for motorised chassis).

32 n8.

Problems Found by the Reid Committee to be Inherent in Certain Business Relationships

Franchising Generally	New Motor Dealers – Areas of Dispute
1. Charging excessive prices on goods supplied.	1. Termination at will.
2. Secret rebates from suppliers.	2. Rights of assignment.
3. Discrimination between company owned and franchised outlets.	3. Appointment of other dealers in Prime Market Area.
4. Encroachment on franchisee's geographic trading area.	4. Limitation of distributor's right to terminate.
5. Failure to address lack of viability of franchised outlets.	5. Security of tenure and duration.
6. Making substantial increases to renewal fees.	6. Distributor's obligations to supply.
7. Failure to supply adequate service and support to franchisees.	7. Unilateral variation of franchise agreement.
8. Unwillingness to discuss and negotiate problems.	8. Compulsory dealer contributions.
9. Using advertising levies for other purposes.	9. Compensation for stock on termination.
10. Intimidation and victimisation of franchisees; and	10. Dealership structure.
11. Unfair terminations.	11. Access to financial records.
	12. Payments.
	13. Performance criteria; and
	14. Other (competing franchises, multi-franchising; superseded new vehicles).

The above matters were considered to be symptoms of franchising relationships in particular. Of course, many of them are not inherently franchising issues at all but issues of human and commercial relationships generally. Any purchaser of goods may well argue that the prices she or he is required to pay are "excessive". An unwillingness to discuss

problems is as much a problem of employer/employee and matrimonial relationships. Many issues set out in the *Reid Committee Report* are issues of simple contractual agreement. The duration of the agreement, the territorial area it covers and the like are matters on which, one might think, parties should be able to reach their own agreement uninhibited by legislative controls. Unless franchising is in some way "different", one might well conclude that the whole question can be dealt with as one of freedom of contract, backed up by the sanctions for misleading or unconscionable conduct and misleading representations set out earlier.

Having said that, however, there are elements of franchising which are different from standard contractual relationships. These are not clearly articulated in the *Reid Committee Report*. However, as I see it, the following are relevant considerations:

1. Franchising is an "ongoing" relationship. It is thus more than a single buy and sell transaction which may typically be covered by contract law.
2. Because it is an ongoing relationship, genuine issues of disagreement often cannot usefully be litigated. A court case inevitably destroys an ongoing relationship, whatever the outcome of such litigation. It is, therefore, important that there be a method of resolving disputes without destroying the relationship between the parties.
3. There are power imbalances in many franchise arrangements. Certainly these exist in many contractual relationships but the fact that a franchisor in many franchising arrangements controls the use of the relevant trade mark and the marketing system involved gives rise to particular market power imbalances. The point about power imbalance in a franchise arrangement is that *the whole* of the franchisee's business may depend upon the franchisor's trade mark and marketing system. This point was seen by the *Reid Committee* as a crucial justification for franchising regulation. Power imbalance is dealt with in detail below.
4. The fact that there are usually a number of franchisees involved gives rise to problems of equity of treatment. Further, the fact that the franchisor itself often also operates outlets which may compete at the same level as franchised outlets may well create difficulties.
5. A major problem is obtaining information in advance of commitment. If a commitment to a continuing and trade name dependent relationship is involved, then franchisors should be required to disclose who they are and what is their track record. This will assist rational decision making by franchisees pre-investment rather than give rise to perhaps futile legal actions once the franchise system has bellied up and franchisee investment has been lost.

Probably, however, the real reason for Government wishing to legislate in relation to franchising lies in the very political process itself. A

Government policy which causes one person to be unemployed in every motel in Australia will create very little concern to politicians because there is no effective group to point out the effects of the policy and bring it into the political debate. A Government policy which closes down a factory in a specific area but with far fewer national unemployment repercussions will, however, immediately leap into political prominence. So it is in franchising. Because one franchisor will often be dealing with a significant number of franchisees, if that franchisor ceases to trade, a considerable number of franchisees are affected. They can organise politically. Because a number of persons are affected, the demise of a franchisor has political repercussions far beyond that of an individual suffering pursuant to a badly negotiated contract. The demise of the franchisor is, in these circumstances, often seen not as the failure of an individual entity for commercial reasons but as a failure of the law to provide franchisee protection.

The same political situation exists even if the franchisor remains solvent. Associations of franchisees in major industries can organise politically and press the evils of the system under which they operate. This can be seen in the *Reid Committee Report*. "Franchisees" in the petrol and motor dealer industries organised to present their various tales of woe. They were successful. To a significant degree, their problems were generalised from their particular industries to be regarded as general problems in the franchising system of marketing.

It is realistic to recognise, and not necessarily to argue against, the political imperatives. What is important, however, is to ensure that only those franchising relationships with power imbalances (see discussion below) are subject to franchising legislation. What is important is to define such franchises with precision and not, in the name of power imbalance to regulate all manner of transactions where this is not present and where traditional freedom of contract, backed up by *Trade Practices Act* and other protections, are the appropriate applicable legal principles which should apply.

VII. The Definitional Issue

The regulatory definition of franchise agreement, as at 1 July 1998, is set out in **Attachment "C"**. The major points in the definition of a franchise can be summarised as follows:

1. A franchise is a written, oral or implied agreement.[33]
2. The definition of a franchise is cumulative. Thus there must be:
   (a) an agreement (see 1 above) in which a right to carry on the

[33] **Attachment "C"** Clause 4(1)(a). The writer is somewhat mystified as to how one can have an implied franchise agreement, but no doubt the draftsperson had matters in mind which are not readily apparent to those who are less informed.

business of offering, supplying or distributing goods or services is granted;[34] and

(b) the granted right to carry on business must be under a system or marketing plan substantially determined, controlled or "***suggested***" by the franchisor or an associate of the franchisor;[35]

(c) the operation of the granted business must be substantially associated or "***materially associated***" with a trade mark, advertising or commercial symbol owned by the franchisor or its associate or specified by the franchisor or its associate;[36]

(d) the franchisee must pay or agree to pay to the franchisor or an associate an "***amount including for example***" amounts paid for various specified items.[37] The examples given include payments for goods or services (except if the goods or services are purchased at or below wholesale prices), fees based on gross and net income and training fees or training school fees.

3. A transfer, renewal or extension of a franchise agreement is deemed to be a franchise agreement.[38]
4. A "motor vehicle dealership agreement" is deemed to be a franchise agreement.[39]
5. Various relationships do not, of themselves, constitute a franchise agreement.[40] These include employment, partnership, landlord and tenant and mortgagor/mortgagee relationships.
6. There are exclusions for:
   (a) A foreign franchisor who grants only one master franchise agreement in Australia.[41]
   (b) A franchise agreement to which another mandatory code is applicable.[42]
   (c) A franchise agreement which is for:
   goods or services substantially the same as those supplied for a
   (i) two-year period prior to entering the franchise agreement and which:
   (ii) are likely to provide less than 20 per cent of the turnover of the franchisee for the first year of the franchise.[43]
   However, this exemption ceases to apply if the goods or services supplied exceed 20 per cent of the franchisee's turnover for three years and the franchisee tells the franchisor of this.[44]

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[34] **Attachment "C"** Clause 4(1)(b).
[35] **Attachment "C"** Clause 4(1)(b).
[36] **Attachment "C"** Clause 4(1)(c).
[37] **Attachment "C"** Clause 4(1)(d).
[38] **Attachment "C"** Clause 4(2)(a).
[39] **Attachment "C"** Clause 4(2)(b).
[40] **Attachment "C"** Clause 4(3).
[41] **Attachment "C"** Clause 5(3)(a).
[42] **Attachment "C"** Clause 5(3)(b).
[43] **Attachment "C"** Clause 5(3)(c).
[44] **Attachment "C"** Clause 5(4).

Comments on the definition of a franchise

The following comments can be made on the definition of a franchise agreement.

1. Virtually every trade mark licence agreement will be a franchise agreement. This is because such agreements usually have quality control provisions built into them. These will probably be sufficient to constitute a material association with the business and a situation where the licensor is at least suggesting a system of offering goods or services. There will usually be a licence fee which will be based on a percentage of income from the sale of the product produced or distributed under the licence agreement. Thus, all aspects of Clause 4 of the franchise definition will be satisfied.

It has been privately put to me by one commentator that the word "suggested" has to be interpreted as involving an element of compulsion in view of the context in which the word appears. I reject this view. The plain meaning of the word "suggest" is devoid of any element of compulsion.

2. Clearly enough, the definition will extend to parties who are not image dependent upon a franchisor's logo. This is because many trade marks or commercial symbols will be materially associated with a business under a marketing plan substantially determined or *suggested* by the trade mark licensor, even though the particular marketing plan may relate only to a small part of the franchisee's overall business.

There is an illusion on first reading Clause 4(1)(b) of the definition of a franchise in the Code that the business of the franchisee must be conducted under a marketing plan substantially determined or suggested by the trade mark licensor. This is not, however, the case. The definition merely requires that a marketing plan be substantially determined or suggested by the licensor and that the business only be "materially associated" with the trade mark of the licensor. A business in which, say, ten per cent of a franchisee's turnover relates to trade marked items is surely one with which the licensor's trade mark is "materially associated". If the trade mark licensor then goes on to "suggest" a marketing plan in respect of the trade mark licensed product, a franchise will almost inevitably be involved.

Of course, one way to negate this result is for the trade mark licensor not to suggest any marketing plan. The result of this course, if adopted, would be that small business would lose much of the valuable assistance which can be provided to it by licensors. This, one would think, hardly furthers the interests of small business, that class of persons for whose benefit the *Franchising Code of Conduct* has been promulgated.

3. The definition does not require a supply-dependent position. A franchisor must grant to another the right to carry on the business of offering, supplying or distributing goods. But this does not have to be the sole business or even the major part of the business of the franchisee. If I produce soft drinks and I grant to a corner store "the right to carry on the business of supplying my goods (soft drinks)" then I will go a long way towards coming within the franchising definition if I also "suggest" a marketing plan and if my trade mark is "materially associated" with the operation of "the business".[45]

4. In order for there to be a franchise there must be a payment of some fee to the franchisor. This must be a payment other than a payment for goods or services at or below wholesale price.

There are some problems in relation to the fee to be paid and its definition.

(a) One can imagine that there will be numerous fights as to what constitutes a "wholesale price". It is not at all unusual for small business to allege that it buys at the price at which big business sells. This situation occurs because of the volume discounts which big business can attract. What is the "wholesale" price? - the price at which big business is supplied, that at which small business is supplied or some other price? Because there is usually a variety of selling prices to retailers, there is no doubt that the term "wholesale price" is not uniform and will be the subject of much debate.

(b) In any event, this definitional provision is satisfied if a franchisee pays "a training fee" or "training school fee". With ever more sophisticated products on the market, it is quite usual to require all distributors or stockists to undergo basic skills training. It is not unusual for product suppliers to require some financial contribution in respect of the training provided. The effect of the definition of franchising is that, in many industries, "franchisors" will have to conduct training courses for free or run the risk of being a franchise with all the attendant costs of franchise compliance. It seems quite wrong that whether or not there is a franchise may depend upon whether or not a training fee is charged.

The effect of the provision may be that some training will prove too expensive for suppliers to provide free of charge and will be dropped. One cannot see how this possible result assists business, big or small.

[45] If "the business" is the "business of supplying soft drinks", it is inevitable that the franchisor's trade mark will be "materially associated" with it. Even if the business is the operation of a corner store, the soft drink manufacturer's logo must be regarded as "materially associated" with that business. The payment of a fee will still be required. Not unusually, however, this will be based on a figure varying with sales profit and hence the arrangement will satisfy all the requirements of the franchise definition in the Code.

(c) The definition of the fee to be paid may well operate so as to exclude from the coverage of the Code some of those dependent arrangements which should classically be controlled. A totally dependent franchisee may have a fee which is structured on a fixed fee instalment basis (e.g. a trade name licence at $X per month). This is not a fee based on income. Nor is it an initial capital investment fee. It is a fixed revenue payment. Therefore, it is not a fee within the definition in Clause 4(1)(d) of the *Franchising Code of Conduct*.

Also, because a fee has to be based on gross or net income in order to come within the definition in the Code, it seems that a fee payable simply on units purchased is not a fee within the Clause. A fee payable on a number of units purchased is not a fee relating to gross or net income. The number of units purchased is not a measurement of income, gross or net.

One effect of the definition of "fee" may be that the Code forces franchisors to adopt fees unrelated to income. This may well be against small business interests as the fee has to be paid regardless of income or profit. In any event, it is surely wrong in principle that certain fee structures should be forced when perhaps everyone would wish them calculated in a different manner.

In short, the definition of the relevant fee in Clause 4(1)(d) may let many franchise arrangements slip through the definitional net in circumstances where there is no doubt that they should be regulated.

The counter argument to that put above is, of course, that the definition of a franchise fee is one of a fee **"including, for example"** the items stated. No doubt, what the imprecision of definition will involve, in due course, is a learned, but possibly very expensive dispute, as to whether licences subject to a fixed revenue fee or fees payable on units purchased are within Clause 4(d) on the principle of legal interpretation of ***"Noscitur a sociis"*** or outside the clause on the interpretational principle of ***"ejusdem generis"***.[46]

All in all, the provisions relating to franchise fees are replete with imprecision. The possibility exists of bringing arrangements within the control net for a completely irrelevant reason (such as the payment of a training fee) or excluding arrangements from control because fees can be constructed so as to be unrelated to revenue.

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[46] **Noscitur a sociis** - A rule of legal interpretation which declares that the meaning of generalised words can be gathered from their context. An argument based on this rule would run along the lines that any fees which are amounts relating to the franchise (other than those specifically excluded) are within the definition of fees within Clause 4(1)(d).
Ejusdem generis - is a principle of legal interpretation which declares that where specific words are followed by general words, the general words are to be read restrictively and confined to the specific class involved. It could thus be argued that the provisions of Clause 4(1)(d)(iii) refer to income and thus they exclude fixed fees or variable fees unrelated to income.

In the paper as originally presented the reference was to units sold. It is thought that units purchased is less related to gross profit than units sold and a change to units purchased has thus been made.

This is an issue which would not be relevant if franchise arrangements involving only trade mark and supply dependency were controlled.

(d) A "motor vehicle dealership agreement" is deemed to be a franchise. Presumably the term "motor vehicle dealership agreement" is capable of interpretation. In the context of motor vehicle dealerships, the *Reid Committee* talked only of motor dealers dealing with motor vehicle manufacturers. One would think that the provisions in the Code cover a much wider area than this. The *Reid Committee* also spoke about problems in relation to farm machinery and motor cycle dealerships. These would appear not to be covered by the provision. Secondhand dealerships did not seem to generate complaints to the *Reid Committee* but would appear to be within the provision.

Hence the general term "motor vehicle dealership agreement" seems both too wide in some respects and too narrow in others if the regulation is meant to carry into effect the findings of the *Reid Committee*. If there was doubt, as the *Reid Committee* though there to be, as to whether motor vehicle dealerships were or were not franchises, one would think that this doubt has not been resolved, at least in the case of motor cycle and farm machinery distributorships.

(e) The exemption in Clause 5(3)(c) that there is no franchise agreement if less than 20 per cent of the business is involved has merit. It is aimed presumably at excluding these arrangements from franchise regulation because there is no power dependency involved in them. This meritorious provision is, however, put at nought when a pre-requisite to its operation is that there has to be a previous two-year supply of substantially the same goods. Why any arrangement which constitutes less than twenty per cent of a franchisee's turnover should be subjected to franchise legislation at all is beyond me.

The two-year prior supply requirements could well be deleted with no loss. No doubt they have some "grandfathering" benefits and thus make the introduction of the Code more politically acceptable. However, they are of no relevance to arrangements where there has been no prior relationship between the parties. Grandfathers have a habit of passing on and the protection of the provisions will thus dissipate quickly with new entrants coming into the market.

One must also wonder at the basic fairness of the proposition that the franchisee can "convert" a non-franchise to a franchise if the turnover in the particular product exceeds twenty per cent over a three-year period. Not only does this have the basic effect of retrospectivity imposing onerous burdens on deemed franchisors but also these burdens are imposed only because there has been a successful marketing of the product involved.

(f) The definition speaks of "persons". The Commonwealth

constitutional power is, of course, primarily based on the corporations power, supplemented by the interstate trade and commerce power. There may thus be constitutional difficulties in total implementation of the Code unless the States enact complementary legislation. I am not aware of any undertaking by the States to do this. Perhaps, however, the Federal Government may believe that it is doing its job adequately even if individuals acting totally within a State escape the Code's net.

An example of the extent of the operation of the definition

It is not hard to see the extent to which the definition of a franchise can go. Let us take a simple, but not uncommon, commercial arrangement by way of an example. I am the proprietor of a restaurant. I engage in joint promotions with a wine company which permits me to use its trade marked labels on my restaurant menu and on advertisements which are placed around the restaurant. The wine company provides me with technical assistance as to the promotion and marketing of the wine involved. This arrangement is well on the way to being a franchise agreement. The franchisor has granted to me the right to carry on the business of selling its wine and the use of a trade mark[47] and also has provided ongoing marketing and technical assistance to me.[48] It seems to me that there is in place a system or marketing plan. There is little doubt that the business of selling the wine company's wine (the granted business) is "materially associated" with the winemakers' trade mark. All that is required is for the wine company to run a training school for some of my staff and charge $50 for them to attend (the cost probably only of the training school dinner or of the wine consumed in "training") for there to be a regulated franchising agreement.[49]

The real problem with the definition of franchise agreement is shown up by the above simple example. The basic problem is that the definition of franchise agreement nowhere specifically requires an overall franchisee business dependence or an overall trade mark logo dependence.

The potentiality for arrangements such as the above to be caught up in the red tape requirements of franchising disclosure and the like is horrendous. The definitional overkill catches in its net a multitude of ordinary commercial arrangements which have nothing to do with a franchisor misusing power and, which would not, in my view, and certainly should not, have been within the contemplation of the *Reid Committee* as requiring regulatory control.

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[47] **Attachment "C"** Clauses 4(1)(a), 4(1)(b), and 4(1)(c) are thus satisfied.

[48] **Attachment "C"**Clause 4(1)(b). This must be a marketing plan "substantially .... suggested".

[49] **Attachment "C"** Clause 4(1)(d)(iv).

Why has this definition of franchise eventuated?

The real problem in the definitional overkill lies in the indecent haste which has marked the whole regulatory process and the manner in which the Government has sought to prescribe the Code. In this regard the following are of relevance:

1. The Reid Committee commented that definitional problems are issues in every piece of legislation and that we should not concern ourselves too much with the issue because there is plenty of overseas precedent on the point.[50] One can comment only that there is, of course, plenty of overseas precedent but the definition of franchising agreement in the Code shows that we have learnt nothing from it.[51]

2. The Reid Committee's concluded that we must crash through with franchising legislation because "enough time has already been lost". The Government has certainly "crashed through" but at the price of not really understanding what the law should be trying to target and thus not specifically aiming the legislation at any target at all.

3. The method of implementing a binding Franchising Code is unfortunate. There is to be no *Franchising Act* and hence no Parliamentary Debate on the relevant issues. The *Trade Practices Act* has been amended and the *Franchising Code* is simply promulgated as a regulation under it. The issues have not, therefore, been properly ventilated in the community as a whole.

4. One of the problems with this method of implementation is the debacle of having a public consultancy period of only some eleven days. Admittedly there were various other draft documents floating around from October 1997, but these were made available only to selected entities on a confidential basis. The final draft was public simultaneously with its promulgation. The whole process by which the Code came into being was a highly unsatisfactory one.

5. The proud statement on the launch of the Code that the Australian Competition and Consumer Commission and the Office of Small Business "have produced" a compliance manual for franchisors as to how they might comply with the Code has turned out, when made, to be a misleading myth. Presumably the manual, if produced, should have been

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50 Above n20 and related text.

51 See **Attachment "C"** and commentary in this **PART VII** for Code definition and discussion. It is not possible here to analyse and discuss all overseas definitions of a franchise. Suffice it to say that, to my knowledge, all such overseas definitions relate to power imbalances as discussed in **PART IX** of this paper. In Australia, power imbalance has been of the essence of franchise definition in the case of the *Swanson and Blunt Committees* (see n69-73 and related text).

available when the statement was made. Enquiries at the ACCC at the time revealed that the manual would not be available until about a month after the Franchising Code came into effect thus making it very difficult for franchisors to comply with the Code within the tight regulatory time frame constraints imposed (some of the legislation to come into effect on July 1, the balance on October 1).

The manual and a short guide to franchisees, however, is now available. One might have thought the first question franchisors and franchisees would want to know is whether they are covered by the Code. Both publications are silent on this point giving no views at all as to how the regulation will be interpreted by its major enforcers. When writing the first version of this paper, I commented that the official guides would be of great assistance in informing us what a franchise was and that I should not speak at that time in too great detail as these publications were not available. I was wrong. The guides are a barren desert on the issue.

Implementation of the Code: a lesson in Government strategy giving rise to the maximum loss of goodwill

The Government could not possibly have created greater difficulties in bringing in the Franchising Code if it tried. As if what is set out earlier is not bad enough, more follows.

I had my librarian try to obtain a copy of the first draft Franchising Code from the Sydney Office of the Australian Competition and Consumer Commission, the body meant to be administering the Code. My librarian was told that the Sydney office of the ACCC knew nothing about it but that "it was probably on the Internet." Subsequently a copy was found on the Internet. The exercise showed, however, that political apostolic zeal simply outran Government planning.

The Government was adamant that the Code would come into force on 1 July. Although I was on the list of people to whom the Office of Small Business was to send the Code as a priority matter, I had not received a copy of the Code at the time of writing the initial version of this paper. Neither had I received any advice that the final code had, in fact, been settled. The fact of settlement of the Code a couple of weeks prior to my writing the original version of this paper was found out only by chance because I happened to read a small press report to this effect.

Trying to advise agitated clients on the Code in late June when the official Government view was that the Code was to come into effect on July 1, the Code itself however having no tangible existence, is hardly a pleasurable experience for either lawyer or client.

In fact, the Government deferred operation of some parts of the Code until October 1. No doubt, the Government feels that it has been kind to business in doing this. Some aspects of the Code still, however, came into

force on July 1.[52] Business might have been happier if some statement had been made in early June as to the October 1 date in respect of those deferred aspects of the Code thus saving much legal and executive ulceration in the second half of June.

However, even the three months' deferment period was not, in fact, three months. The ACCC had not prepared its Guide to Franchisors when the Code was promulgated. It was not available until about a month after this. If politicians were engaged in trade or commerce, the Ministerial Statement, at the time of promulgation of the Code, that the ACCC had prepared such a Guide would, one would think, be misleading or deceptive conduct and actionable under s52 of the *Trade Practices Act*.

I wrote to the Minister for Small Business, Mr Reith, expressing the opinion that the code regulation was hard to find and was promulgated far too late in view of its onerous requirements. Even the ACCC, the principal enforcer, was in the dark shortly before the Code's promulgation. The problem of finding the Code was, in my view, even greater for those engaged in small business, said to be the class to be protected by it. The reply received was that the Franchising Code was available from a considerable number of sources including the Internet. It was, therefore, fascinating to sleuth out a copy of the Code on the Internet (for, at the time of writing the initial version of this paper, none had been provided in hard print even though promised) and be greeted with the following on the copy obtained:

> "The Commonwealth and its employees, officers and agents do not accept any liability for any action taken in reliance upon, based on or in connection with this document. To the extent legally possible, the Commonwealth, its employees, officers and agents, disclaim all liability arising by reason of any breach of any duty in tort (including negligence and negligent misstatement) or as a result of any errors and omissions contained in this document."[53]

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[52] See **Attachment "C"** Clause 5(2). As from July 1, franchisors have to provide copies of leases; advertising and other co-operative funds are controlled and franchisors cannot inhibit the formation of franchisee associations. The balance of the Code applies as and from October 1, 1998.

[53] This disclaimer may well be needed. The printed copy of the Code as distributed to industry and commerce by the Government after the writing of this paper has a Preamble to it. The impression from the printed Code is that the Preamble is part of the gazetted regulation and thus has the force of law. Nowhere does the document forwarded point out that the Preamble is not gazetted. Nowhere in the Government copy of the Code is there any reference to gazettal or what has been gazetted. The Preamble contains some important material. It implies, for example, that, as a matter of law, the Code is to be reviewed within three years. It implies that, as a matter of law, there is a body called the Franchise Policy Council and that this body has certain tasks. Neither of these observations is correct as a matter of law as the Preamble to the Code is not part of the Code Gazetted Notice. [See *Commonwealth of Australia Gazette* 25 June 1998 and *Statutory Rule No 162 of 1998*.] There are other important matters in the printed copy of the Code about which the same comment could be made.

The Department's desire for something to be "the law" is understandable but the law is not created by Departmental desire. The printed copy of the Code as distributed certainly gives the impression that everything in it is the law whereas this is not the case.

Definitional amendments which should be made

The final June Code definition certainly improves on the April draft definition in that it attempts to make franchisee dependence greater than previously. Unfortunately, however, this is only an appearance as the definition does not carry this appearance into actuality. This is because the definition prescribes in Clause 4(1)(b) that *the offering of supply of goods or services* is caught if this is to be in accordance with a franchisor's marketing plan (even a "suggested" one). What should instead have been provided is that *the business of the franchisee* (rather than the distribution etc of certain goods or services) involves a franchise if it is to be conducted in accordance with a plan substantially determined by the franchisor.

The definition retains the words *"materially associated"* in Clause 4(1)(c). Virtually any trade mark would appear to be "materially associated" with a business which distributes trade marked goods or services. Had the words "materially associated" been dropped, the provisions would then apply only to a business whose operation is substantially associated with the relevant trade mark. This would be a much more acceptable situation.

The exemption in Clause 5(3)(c) goes some way towards defining the dependency relationship. If less than twenty per cent of the franchisee's expected business is involved, there is no franchise agreement. There seems to be no reason why there should be any qualifications to this provision, however. If the franchise definition were amended to cover only overall business dependency situations, then such a provision would not, of course, be necessary.

A suggested amended definition based on the present definition

Assuming that it is all too hard to return to the drawing board and that amendment to the current definition is all that can be achieved without too much loss of political face, all is not irredeemably lost. A definition amending the present definition, and which might make some sense, could be:

"A franchise agreement is an agreement, written or oral:

(a) by which a person (the franchisor) grants to another person (the franchisee) a right to carry on a business and **the franchisee's overall business** is to be conducted under a system or marketing plan substantially determined or controlled by the franchisor or an associate of the franchisor; and

(b) under which **the overall and public identity of the franchisee's business** is substantially associated with a trade mark or advertising or commercial symbol:

(i) owned, used or licensed by the franchisor or an associate of the franchisor; or

(ii) specified by the franchisor or an associate of the franchisor."

I wish to make it quite clear that the above is not the definition of a franchising agreement which I would necessarily advocate. However, it is a definition which takes into account the "power imbalance" circumstances found by the *Reid Committee* to be the major problem in franchising and it is a definition which builds upon the framework of the present one.[54]

Either the above definition or the definition suggested by the *Swanson Committee* in 1976 (as to which see the following paragraphs) would, if adopted, answer many of the criticisms which I believe can be made as to the scope of the definition of franchising in the Franchising Code.

One must conclude by commenting that at this stage no-one knows how the ACCC will interpret or enforce the Code. Neither the guidance publications referred to nor any other publicity documents give us any clues as to the ACCC's thoughts.

VIII. What Does A Franchisor Have To Do?

This paper is more concerned with the coverage of the Franchising Code than with its obligations. However, for the sake of completeness, brief reference is here made to the obligations of parties under the Franchising Code.

Major obligations under the Code

Some of the major obligations and provisions in the *Franchising Code of Conduct* are:

1. A franchisor[55] must provide a disclosure document in the form of Annexure 1 to the Code. The purpose of this document is to give a prospective

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[54] It follows from the above definition that provisions relating to franchise fees [**Attachment "C"** Clause 4(1)(d)] or exclusions for less than 20 per cent of business [**Attachment "C"** Clause 5(3)(c)] are no longer necessary.

The definition of a "franchise" in the Code of Conduct (see **Attachment "C"**) is apparently taken from the *Swanson Committee* definition. However, there are significant differences between the two - as to which, see n.70. The above definition is aimed to reflect *Swanson Committee* thoughts whilst using and adapting the words of the Code of Conduct definition.

The definition above has been varied from that in the paper given on 6 August 1998 to take into account observations made on the original definition.

[55] Akin obligations apply to subfranchisors. For the sake of simplicity of presentation, the obligations only of franchisors are here referred to. This paper does not refer at all to the obligations of franchisees who sell their franchises.

franchisee information to help him or her make a reasonably informed decision about the franchise.

2. The disclosure document must be given at least 14 days prior to the franchisee entering into an agreement to enter into the franchise agreement or paying any non-refundable money to the franchisor or the franchisor's associate.

3. Before a franchise agreement is entered into a franchisor must receive from the franchisee signed statements that the franchisee has been given advice by any of:

(i) an independent legal adviser;
(ii) an independent business adviser;
(iii) an independent accountant; *OR*
(iv) for each kind of statement of the above kind not received, a signed statement that the franchisee has been given that kind of advice or that he has been told to seek that kind of advice but has decided not to seek it

4. There is a "cooling-off" period of seven days after entering into a franchise agreement. If the franchisee terminates the agreement in this period, the franchisor must return all moneys to the franchisee less any reasonable expenses if their method of calculation is set out in the agreement.

5. As and from 1 July 1998, if a franchisee leases premises from the franchisor, the franchisor must give the franchisee a copy of the lease within one month of its signature. No doubt this is commendable but, as far as this writer is aware, it is no addition to the general law pursuant to which a lessee is, of course, entitled to a copy of his lease document.

6. As and from 1 July 1998, a franchisor must not induce a franchisee not to form an association or not associate with franchisees for a lawful purpose. This is, in my view, a commendable provision.

7. There is a general prohibition after 1 October 1998 on requiring a franchisee to sign a general release of the franchisee from liability to the franchisor.

8. Co-operative advertising funds must be properly audited and moneys accounted for unless 75 per cent of franchisees in Australia who contribute to any such fund determine to the contrary. This provision applies from July 1, 1998. It has much to commend it

9. There is a requirement to disclose a barrage of convictions and civil judgments against the franchisor if these exist.

10. A current disclosure document must be given to the franchisee within 14 days of a written request. A franchisee can, however, make such a request only once in any 12 month period.

11. There are some fairly elementary dispute resolution procedures set out in the Code. However, the Code makes one all too common error. In usual dispute resolution procedures, a mediator is appointed by consensus. The procedures adopted are adopted by consensus. A document is signed which ensures that statements made in the mediation process are not admissible in subsequent court proceedings. Most mediation documents, in my experience, also provide that the mediator cannot be called as a court witness and that parties, with some very limited exceptions, cannot take action against the mediator.

In the Code, however, mediation is a compulsory process and there is no provision for any of the above steps. Since writing the original of this paper, I have been invited to apply to become a franchise mediator. I have declined this invitation. In order to become a mediator, one has, in addition to having mediation qualifications, to agree to conduct mediations in the manner prescribed by the Code Mediation Adviser. The procedures laid down, in my view, have significant deficiencies.[56]

In what now appears to be the standard method of bringing the Code into effect, the Mediation Adviser, whilst requiring compliance with its procedures, was unable to produce at the time of this demand, a copy of these procedures. They were finalised after the invitation letters were despatched and, in fact, after the date originally set for acceptance of the invitation to apply for appointment. It is my hope that not too many mediators agreed to accept appointment thinking that the usual mediation provisions would be applicable.

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[56] The procedures laid down by the Code Mediation Adviser *require* the mediator to give evidence in court as to any settlement reached. Further, the mediator is *required* to furnish a report on the mediation to the Mediation Adviser, such report giving the mediator's views on such things as whether the parties have mediated in good faith. The mediation agreement itself states that all matters in the mediation are confidential. My fairly simplistic view is that the mediator should not give any reports to anyone having stated to the parties that the mediation is confidential. The mediator could be sued for doing so. Anything said in the report would not be protected by the litigation waivers in the mediation agreement as the report is not part of the mediation at all but an unrelated and not authorised subsequent activity. Further, the matters upon which the mediator gives an opinion could possibly be determinative of substantive rights (e.g. much could substantively depend upon whether or not parties participated in a mediation in good faith) thus making the mediator an adjudicator rather than a facilitator. All of this is, in my view, contrary to best mediation practice. No regulation supports what the Mediator Adviser requires. Even if there were such a regulation, it must be doubtful whether it can overrule specific legislation which may exist to the contrary - for example, a mediator's report does not seem to attract any privilege under legislation covering court processes and evidence and it must be doubtful if a regulation could overrule these legislative provisions. Questions of both State and Federal law would have to be addressed as issues relating to the mediation may well arise in litigation based on State legislation. Because of these problems, it is in my view that only legislation can properly regulate the mediation process.

In my view, proper mediation procedures are possible only if there is legislation with the relevant procedures and safeguards embedded into it. The Government's regulatory path means that the essential elements of mediation are not law. Neither, in my view, is what is sought to be implemented in accordance with best mediation practice. The Department's desire, for example, to have a mediator break the mediation confessional and furnish what appears to be an unauthorised report as to the conduct of the parties at the mediation is, in my view, quite contrary to best mediation practice. It certainly has no legal sanction as this procedure is not part of the promulgated Code. Unfortunately, there are probably a number of mediators who do not realise this thinking, not unreasonably, that the Department has the benefit of the law as a backing to its actions.

The Government's headlong "crash through" approach of prescribing the *Franchising Code of Conduct* instead of legislating it may well mean that one of its strongest points (providing for appropriate mediation and alternative dispute resolution processes) may not become a reality. This would surely be a pity but it must be a potential result.

12. The information to be set out in the disclosure agreement to be provided to the franchisee is, to many, an overkill and, even those kindly disposed to the need for regulation would describe it as "comprehensive". It has 23 itemised major subject matter areas. These are divided into 53 subparagraphs involving major information areas. These subparagraphs are themselves divided into some 147 sub-subparagraphs and 20 subparagraphs of sub-subparagraphs.

There can be no variation from the form, order or numbering of the format of the pre-disclosure document set out in the Annexure to the Code.

Comment on the obligations under the Code

Many of the obligations under the Code are commendable if one premises a franchisor's obligations on the assumption that the Code relates only to trade name or marketing system dependent franchisees. However, this is far from the case. In other than franchise dependent situations, there really is no case for any of the regulatory requirements.

Even in a franchisee dependent situation, the Code does have its problems.

1. It is by no means clear what advice a franchisee has to take and from whom such advice has to be taken.

2. Provision of disclosure documents to franchisees each twelve months may well place a considerable burden on franchisors.

3. There is considerable risk that one of the real advances that could have been made in franchising, that is the provision of appropriate dispute settling mechanisms, could fail because the relevant pre-requisites for such a system are not in place. Only a statute setting out the relevant procedures can ensure that dispute resolution will make the contribution to franchising which it undoubtedly has the potential to do.

4. Even if all the matters in the pre-disclosure document are relevant, the ends sought could have been achieved far less heavy handedly. For example, it seems strange that a pre-disclosure document requires "Summaries" of certain leases, hire purchase agreements and mortgages. To "summarise" such documents is far from easy and may, in many cases, simply lead to a cumbersome and prolix pre-disclosure document which loses all meaning. As advice on the franchise has, apparently, to be obtained, one might think that copies of the actual or prospective documents themselves might be adequate disclosure.

5. One cannot leave the topic of the drafting of the disclosure document without commentary on the new trend in national documents of having the legal yardstick of evaluation as being the law applicable in the Jervis Bay Territory. In the disclosure document a "serious offence" is a breach of a State or Commonwealth law "for which, if the act or omission had taken place in the Jervis Bay Territory, a person would be liable, on first conviction to imprisonment for a period of not less than 5 years".

This is a rather cute way of drafting. It suits bureaucrats who want a central reference and now argue that the ACT laws, the traditional yardstick, are no longer appropriate in view of the independent Government of the ACT. So we have to refer to a "pure" Commonwealth Territory - and Jervis Bay is it.

The difficulties in all of this are quite apparent. How anyone other than bureaucrats in Canberra or Jervis Bay are ever likely to be able to find the laws of Jervis Bay is self evident. When I was in the ACT, I found it hard enough to find out which NSW laws were, and which were not, applicable in the ACT and whether these had or had not been amended. In the case of Jervis Bay, a further step has to be taken to ascertain which ACT laws apply there and what other laws apply there which are not ACT, but Commonwealth, "sourced". This whole exercise is a very difficult one for anyone outside the ACT or Jervis Bay who wants to find out the relevant law applicable to the *Franchising Code of Conduct*.

There is some logic in applying the laws of Jervis Bay when uniformity is totally necessary. Such is the case, for example, in relation to the Defence Force. The *Defence Force Discipline Act* thus adopts this drafting technique for good reason. However, we could all live, I think, with a serious offence in the Franchising Code being one which, *in the relevant State or Territory of conviction*, carried a penalty, on first conviction, of not less than 5 years' imprisonment. At least lawyers in most parts of the

country would be able to access the relevant law if this were the case.

I was for a couple of decades an RAAF Reserve Officer and had a fair bit to do with the *Defence Force Discipline Act*. Though not arguing with the necessity in that Act to refer to the law of Jervis Bay, from first hand experience I can vouch for the fact that the law of Jervis Bay is frequently not all that easy to find.

6. Within the context of trade mark and systems dependent franchising, the Code may well have benefits. Lest I here appear too negative on the question of franchising regulation, I must stress that there are positives in the provision of pre-franchise disclosure information provided the obligation to do this is confined to appropriate franchisee dependent situations. Perhaps, however, the Code could have provided some simpler ways of making this information available.

7. In franchisee dependent situations, the provisions in relation to auditing of advertising and promotion accounts have much to recommend them. Prohibiting blanket general releases also has much to recommend it, although this appears already to be the law.[57] As far as providing that franchisors should not prohibit franchisee associations, in 1982 I advised the then Minister for Business and Consumer Affairs, the Honourable John Moore, that:

> "There are ... relatively inexpensive steps which could well be taken to redress the balance between franchisors and franchisees. For example, there should be an absolute prohibition on clauses in franchise agreements (known in the US as 'redneck' clauses) which prevent a franchisee participating in franchisee associations. These associations do much to redress balances of power between franchisor and franchisee."[58]

IX. Power Imbalances

Statutory provisions previously noted

As we have seen, there is already a wide variety of legislative remedies which have been used by, and are available to, franchisees.[59] Where these remedies are adequate, there is no reason for additional remedies. It is

[57] The writer believes that this conclusion can fairly be read from *Novamage Pty Ltd v Cut Price Deli Pty Ltd* (1995) ATPR ¶ 41-389 (see text related to n62).

[58] W J Pengilley: "Franchising - What Impact: What Problems: What Solutions?", *Report to Minister for Business and Consumer Affairs, the Hon. John Moore*, Monash University Monograph, 1982. The writer was in these comments speaking of the franchise relationship in the context where there was franchisee dependence.

[59] See text above.

submitted that these remedies are adequate except where there is what the *Reid Committee* characterised as a power imbalance.

The case law of franchisor obligations

Present case law imposes considerable obligations on franchisors. To the extent that this case law seems to be unrecognised anywhere in the *Reid Report*, this Report must be regarded as not taking into account the formidable legal protections already in place. Necessarily, because of this, the need for further protection is overstated.

It is the law that, in the case of a franchise agreement, the courts will imply a term that:

> "... the (franchisor) company would act in good faith in the sense that it would not discriminate against a particular dealer for no good reason and that it would not act with reckless indifference towards the needs of any particular dealer."[60]

There is a duty on a franchisor:

> "to ensure that, over time, one dealer (is) not significantly disadvantaged by comparison with others, having regard to all relevant circumstances".[61]

A franchisor has certain duties in the treatment of franchisees. Thus, a franchisor cannot impose terms on a franchisee that the franchise may be terminated in the event that the franchisee institutes legal proceedings against the franchisor. This is because it is not possible at law to create rights and at the same time deny the other party in whom those rights vest their right to invoke the jurisdiction of the courts to enforce them.[62]

A franchisor must genuinely investigate a complaint made against a franchisee and cannot terminate a franchisee because of a complaint without conducting such an investigation. This is so even if the franchise agreement itself gives a wide discretion to the franchisor and the termination was because the franchisor feared for its image.[63]

If a franchisor does not select an appropriately qualified franchisee or fails to train and supervise the business of a franchisee, the franchisor will be liable in damages to the franchisee to the extent that the franchisor's omission causes loss to the franchisee.[64] Clearly this holding imposes

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[60] *Kellcove v Australian Motor Industries* [Federal Court of Australia: 6 July 1990 (Unreported)]. Such a term must be implied into a franchise agreement because "it goes without saying".

[61] n60

[62] *Novamaze Pty Ltd v Cut Price Deli Pty Ltd* (1995) ATPR ¶ 41-389.

[63] *Carr v McDonald's Australia Limited* [Federal Court of Australia 16 February 1994 (Unreported)]. The complaint was an unsubstantiated complaint by a female employee of sexual harassment.

[64] *Haynes v Top Slice Deli Pty Ltd* (1995) ATPR (Digest) ¶ 46-147.

training and supervision requirements on a franchisor.

It is well established law from the two *Barbara's House and Garden Cases*[65] that misrepresentations as to turnover figures will render a franchisor liable as will incorrect generalised statements such as "there is no risk of loss". A statement of opinion made by a franchisor conveys that there is a basis for it, that it is honestly held and when expressed as the opinion of an expert, that the opinion is honestly held based upon relevant expertise.

The above cases illustrate that in many areas there are existing effective laws which govern the conduct of franchisors quite independently of any specific legislation relating to franchising.

The real issue, therefore, is to find those areas in which the franchising power balance is so actually or potentially distorted that legislation additional to that which is already in place is necessary.

Power imbalance

Even if the *Reid Committee's* definition of franchising[66] is accepted, it is obvious that not all, almost certainly not even a majority, of the transactions coming within that definition involve power imbalances.

The issue of those franchising contracts meriting legislative control was, relevantly, first considered in Australia by the *Swanson Committee* in 1976.[67] Though the Swanson Committee utilised exactly the same definition of franchising as did the 1997 *Reid Committee,*[68] the *Swanson Committee,* in dealing with the question of franchising control, said:

> "Before discussing the circumstances in which we recommend a remedy be available, and the nature of that remedy, we should describe with more precision the type of relationships between franchisor and franchisee which should be susceptible to this remedy."[69]

The 1976 *Swanson Committee,* therefore, did what those implementing the 1997 *Reid Committee Report* did not. It took a general definition of franchising (the same definition was taken by the *Reid Committee*) but

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[65] *Bateman v Slatyer* (1987) ATPR ¶ 40-762; *Spears & Ors v Barbara's House and Garden Retail Ltd* [Industrial Commission of NSW: Bauer J: Matter No 1420 of 1985: Judgment 30 March 1987].

[66] See text related to n12.

[67] *Trade Practices Review Committee - Report to Minister for Business and Consumer Affairs* (August 1976) [TB Swanson: Chairman].

[68] See text related to n12.

[69] n67 p37. Note that the *Franchising Code of Conduct* definition of a franchise (see **Attachment "C"**) seems to take the *Swanson Committee* definition as a base. However, there are vast differences between the two even though these differences are not, on an initial reading, readily apparent - see n70.

then looked at the transactions within that definition which merited legislative attention.

The *Swanson Committee* thought that, before legislative intervention was merited, the franchise agreement had to be one of three types, these types being:

> "(a) a contract whereby the franchisee is granted the right to engage in a business of offering, selling or distributing goods or services under a market plan prescribed in substantial part by the franchisor, and where the operation of the franchisee's business is to be substantially associated with the franchisor's trade mark, service mark, or trade name, or any other commercial symbol; or
>
> (b) a contract whereby the franchisor grants to the franchisee the right to resupply either as principal or agent, goods supplied to the franchisee by the franchisor but only when the substantial identity of the franchisee's business in fact depends predominantly upon the use of the trade mark, trade name or other commercial symbol; or
>
> (c) a contract whereby a franchisor grants to the franchisee the right to use the franchisor's trade mark, trade name, service mark, trade name or other commercial symbol in connection with the contract and where the substantial identity of the franchisee's business in fact depends primarily upon the use of the trade mark, service mark, or trade name, or other commercial symbol."[70]

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[70] n67 p38. The definition of a franchise agreement in the Franchising Code of Conduct (see **Attachment "C"**) obviously takes the *Swanson Committee* definition (Par (a) in the text) as its precedent. However, it modifies this definition to achieve a quite different result. The modifications are apparently inconsequential but they are, in fact, crucial. The following modifications to the *Swanson* definition have been made in the *Code of Conduct:*

(a) Swanson speaks of the identity of the franchisee's business as being what is relevant in relation to the franchisor's trade mark. The *Code of Conduct* speaks of the business which the franchisee has been given the right to conduct as being that which is relevant to an association with the franchisor's trade mark. There is an immense difference. The *Code of Conduct* has an extremely wide coverage. The *Swanson Committee's* definition is quite limited. [See (d) below as to how this difference flows from the *Code of Conduct* wording.]

(b) Swanson talks about the necessity for any marketing plan to be **prescribed** in substantial part by the franchisor. The *Code of Conduct* lowers this requirement substantially. Under the Code the relevant marketing plan has only to be **"substantially suggested"** by the franchisor. Swanson brings in only mandatorily enforceable marketing plans. The Code incorporates any suggested marketing plans. Suggestions are often made by suppliers leaving it up to the re-seller of the items to accept or reject the advice as they wish. The *Code of Conduct* definition makes business suggestion a hazardous venture.

(c) Swanson talks about trade marks being **"substantially associated"** with the operation of the franchisee's business. The *Code of Conduct* talks about the operation of the granted business being **"substantially or materially" associated** with the franchisor's trade mark. The latter is a much lower threshold especially when the business actively covered in the *Code* is much narrower than that in Swanson (see (d) below).

(d) Perhaps most importantly of all, Swanson and the *Code of Conduct* are talking about quite different things. Swanson talks about the **"franchisee's business"** throughout. This, of course, means the overall business conducted by the franchisee. The Code talks about the grant of a right to carry on *the* business of offering, supplying or distributing goods or services. It then speaks about *"the business"*, meaning presumably the business in respect of which the conduct right is given. If I, therefore, permit a corner store to stock my ice cream, *the business* in respect of which I permit the corner store to engage is that of selling my ice cream. This is the only business in respect of which I can grant a right to

The 1979 *Blunt Committee*[71] put the matter this way:

> "The concept adopted by the Committee is that of a continuing commercial relationship whereby one party (the franchisor) grants to another party (the franchisee) the right to conduct a separate business which is, however, indelibly and publicly linked with the identity of the franchisor. The link to the franchisor will always involve the licensing of the use of a relevant trade mark or name and/or user of particularly distinctive shapes or colours if they are not a registered mark. The Committee does not wish to cover "loose" commercial arrangements, not reduced to written form."[72]

The *Blunt Committee* recommended the enactment of franchising legislation involving pre-disclosure, protection on termination and the like, but only in the case of franchises coming within the above restricted understanding of the term.[73]

The two 1986 *Draft Franchising Agreements Bills* adopted a similar restricted approach. The coverage in the first of these Bills stressed the necessity for franchisor power of control and franchisee trade mark identification with the franchisor. The second of the Bills emphasised trade mark identification and franchisee dependence on goods or services provided by the franchisor.[74]

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anyone to offer, supply or distribute goods or services. Necessarily, the corner store's business in respect of which I give a right is materially associated with my ice cream trade mark. No other business is referred to in the definition in the *Code*. Swanson avoids this narrow definitional result by referring throughout to the "franchisee's business". The *Code* does not do so.

The *Code* has thus achieved an absurdly wide coverage of those transactions which involve regulated franchising arrangements. Swanson was correct. Only if the **franchisee's overall business (as distinct from the business granted, say as a reseller, of a product, by a supplier),** is dependent on a franchisor is there any need for franchise regulation.

71 *Report of the Trade Practices Consultative Committee: Small Business and the Trade Practices Act* (December 1979) [RG Blunt: Chairman].

72 n71 p104.

73 The *Blunt Committee* (n71 p111) recommended that legislation applying to franchising arrangements define "a franchise" as follows:
"'Franchise' means any continuing commercial relationship whereby a person (the franchisee) supplies or seeks to supply goods or services which are identified by a trade mark, service mark or trade name, under licence from another person (the franchisor) and the franchisor exerts or has the right to exert such an influence over the business affairs of the franchisee that the business of the franchisee is publicly and substantially identified with the franchisor or business of the franchisor."

The Committee's definition went on to exclude from the definition of a franchise unwritten arrangements, partnership and employment relationships, relationships not involving a franchise fee in excess of $500 and trade mark etc licences constituting a single transaction.

74 Major objections raised to the 1986 *Draft Franchising Bills* were not so much in relation to their coverage as to the minute degree of regulation involved. For example, the size of print which could be used in documents was regulated and there were a variety of accounting obligations imposed on franchisors. Quite inappropriate valuation principles taken from the *Income Tax Act* were applied to stock and inventory valuations. Valid objection was also taken to the tortuous drafting style - in particular in the First Draft Bill. There were definitions in the Bill of "agreement", "franchise agreement", "agreement concerned", "prescribed agreement", "eligible agreement", "excluded agreement",

The case for legislative uniformity

One would think, if nothing else, that there is a case for legislative uniformity in matters relating to franchise disclosure and investment.

Section 9 of the *Corporations Law* requires certain disclosures in relation to "participation interests" other than a right or interest exempted by regulation. Regulation 7.1.02 of the *Corporations Regulation* provides that a franchise is exempted from the requirements of s9 of the *Corporations Law*. The definition of "franchise" in Regulation 7.1.02 has four interconnected cumulative provisions which state that a franchise agreement is one whereby:

> "(a) a party to the agreement or arrangement (in this definition called the franchisor") authorises or permits another party (in this definition called "the franchisee"), or a person associated with the franchisee, to exercise the right to engage in the business of offering, selling or distributing goods or services in Australia or in a external Territory, under a marketing plan or system controlled by the franchisor or a person associated with the franchisor; and
>
> (b) the business carried on by the franchisee or the person associated with the franchisee, as the case may be, is capable of being identified by the public as being substantially associated with a mark identifying, commonly connected with or controlled by the franchisor or a person associated with the franchisor; and
>
> (c) the franchisor exerts, or has authority to exert, a significant degree of control over the business; and
>
> (d) it may reasonably be expected that, in carrying on the business, the franchisee or a person associated with the franchisee is, or will be, substantially dependent on goods or services supplied by the franchisor or a person associated with the franchisor."

Clearly enough, these provisions catch much of the concept of "power imbalance" discussed by the *Swanson Committee* and the *Blunt Committee*. The concept is one of a marketing plan "controlled" by the franchisor. The trade mark is one which is "connected" or "controlled" by the franchisor and the franchisor exerts "a significant degree of control" over the franchisee's business. Finally, it is clearly provided that in carrying on the business the franchisee must be "substantially ... dependent on goods or services supplied by the franchisor".

Though the writer does not believe that the above definition is perfect (but sees no point in analysing this aspect here) it is a precedent which could well have been followed in the *Franchising Code* with benefit. The

"other agreement", "preceding agreement" and "related agreement". Some terms had multiple meanings - for example, the term "prescribed agreement" had three meanings. To find out how a particular arrangement fitted into the Act, it was necessary to make significant subtractions and additions. This was not easy. It was made harder by the fact that the same definitional factors were utilised alternatively in some clauses and cumulatively in others. Everyone thought that the Parliamentary Draftsperson's quill should have been able to produce a better result than this.

Regulations have received an interpretation consistent with the concept of "power imbalance".[75]

Why no consistency with this definition occurred in the *Franchising Code* is beyond me. The *Corporations Law* clearly recognises that franchisee dependence is of the essence of franchising.

Conclusions as to power imbalance and the definition of franchising

The *Franchising Code of Conduct* (see the definition of Franchise Agreement in Attachment "C") is at odds with the views of other Committees which have faced the issue of what types of franchising arrangements merit legislative control. It is also inconsistent with the present Corporations Law definition of franchise.

Earlier in this paper,[76] various points are noted in relation to the definition of franchising (such definition being set out in Attachment "C"). It is not useful to go over this material. The obvious comment to be made, however, is that there is a substantial overkill involved in the regulation in Australia of so-called "franchising relationships". The definition in the Code results in legislative control of relationships even though they may not have any power imbalance features at all. At the same time, some franchising arrangements may well escape franchising control even though power imbalance clearly exists.

The need for broad brush franchising legislation to control such a wide variety of relationships is very difficult to comprehend when there are other strong legislative provisions which are clearly relevant to them.[77] Equally, the escape of some power imbalanced franchises from franchising regulation is quite inexcusable.

If the definition of those franchising agreements sought to be controlled is appropriately confined, then franchising controls would not have adverse consequences and can be seen to have franchisee benefits. In this paper, I am not so much concerned with those controls which are to be implemented as with those transactions upon which such implementation will impact. My short conclusion is that the *Swanson Committee*, the

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[75] In *Australian Securities Commission v Madison Pacific Property Management Trust* [28 ACSR 297], Lee J held that:

> "The goods or services to be supplied by a franchisor on which a franchisee may reasonably expect to be substantially dependent are those which go to the essence of the business developed by the franchisor and essential for a franchisee to obtain in carrying on the franchised business if the business is to be conducted successfully in the style of the franchisor's business."

[76] See **PART VII.**

[77] See **PART V** and **PART VI.** text.

Blunt Committee and the 1986 *Draft Franchising Agreements Bills* [78] all philosophically got the definitional coverage issue fairly right. The present definitional implementation of the *Reid Committee's Report* has got it quite wrong. It would not be a hard matter to fix.

X. What can be Concluded?

My evaluation of the effect of the *Franchising Code of Conduct* is:

1. As regards franchising arrangements where power imbalance and franchisee dependence is involved, the Franchising Code provisions will have benefit. Also, the requirements should be able to be implemented at no great franchisor cost once the "one off" start up costs in the installation of a system have been met. Perhaps some special consideration based on cost grounds should be given to new franchise systems being established. The cost of a "first franchise" may well be quite out of proportion to any benefit from it and thus franchising expansion may be inhibited. [The extent to which allowance should be made for this is not a matter for consideration in this paper.] However, some power imbalance arrangements will escape the franchising net because of the possibility of restructuring fees so as to be outside the Code's definition of a franchise.

2. As regards industries where there are specific identifiable problems, these should be specifically addressed. The *Reid Committee* spoke at length about motor dealers and their specific problems. Motor car dealers are simply treated as franchisees. Their complaints are specific, however, and they form much of the push for franchising regulation. It seems, therefore, that motor dealer problems should be regarded as industry specific and specific legislation enacted in light of this. This approach has been taken overseas (for example, in the United States, *The Dealers Day in Court Act*). General franchising legislation can deal only with general problems. Specifically identified problems, if thought deserving of attention, can be dealt with only by specific legislation. Many of the iniquities which the *Reid Committee* believed merited general franchising control came from two industries - motor dealerships and petrol retailing. No doubt petrol retailers and motor dealers will benefit from the proposed franchising control. However, general franchising control is not a real solution to their specific problems.

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[78] Re *Swanson Committee* see n67, 69 and 70 and comments in related text. Note that the *Franchising Code of Conduct* definition of a franchise seems to take the *Swanson Committee* draft as a base. However, there are vast differences between the two, even though these differences are not readily apparent - see n70.
Re *Blunt Committee* - see n71 and comments in related text.
Re 1986 *Draft Franchising Bills* - see n74 and related text.

3. As regards a considerable number of arrangements, it is likely that there will, in due course, be some costly litigation as to whether they are or are not within the Code's definition of a "franchise". This litigation could easily be avoided by better drafting.

4. The one thing that could have been dramatically advanced in the franchising area would have been the settlement of disputes by alternative dispute resolution or mediation. However, here the Government has failed. Procedures for mandatory (as distinct from voluntary) mediation need legislative backing to provide procedural rules and mediator protection. Had the legislation route been followed, this could have been done. The issue is completely unaddressed in the Code. This failure is a highly important oversight.

5. If I am correct and the definition of franchising is all encompassing, then:

- many perfectly proper and useful commercial practices will cease; or
- many previously useful commercial practices will continue but at considerable additional cost. This cost will necessarily have to be passed on either to franchisees or consumers; or
- the law will be unobserved and fall into disrepute.

6. Considering that there are already strong sanctions in the *Trade Practices Act* and elsewhere prohibiting misleading or deceptive conduct and akin practices,[79] persons in industries where there is no power imbalance are already well protected and additional legislation will be of no demonstrable benefit to them.

How small business, the industry sector the *Reid Committee* most wants to support, can benefit by a vague definition of a franchise with the distinct possibility of having many of its unobjectionable commercial practices stopped or continued only at substantially increased cost beats me. The only readily apparent explanation is the political desire to be seen to be doing "something" regardless of what that "something" is. Even if the "something" is positively counterproductive or creates real doubts as to what, in fact, it is, no doubt politicians can make the "something" into a political plus. Action, not progress, seems to be the relevant political currency. This is so, even though, in this case, the action involved may well result in less of the real currency for small business and for the economy generally.

[79] n22, n23 and related text; n26 to n28 and rlated text; n31; n60 to n65 and related text.

Attachment "A"

The Casnot Advertisements

See Commentary **Part V** of Text

CLASSIFIED ADVERTISEMENTS APPEARING IN "THE WEST AUSTRALIAN" DURING JANUARY 1979

AAA

$3500

Is all you need to own your own business. We supply the customers, and lease you the equipment. You do the work and reap anticipated rewards of $17,000 in first year. You have a guaranteed area, and we guarantee most of your income.
For confidential interview phone Accent Services 159 Adelaide-tce 3252455.

AAA

CLEANING BUSINESS
First time in WA
In your home area using new but proven cleaning system. We supply the equipment and the contracts. Your do the work and we guarantee income. Full price $7500. Finance on $2500 dep. Apply for appointment 3252455 Accent Services 159 Adelaide-tce Perth.

CLASSIFIED LIFT-OUT

AAA

$3500

Is all you need to own your own business. We supply the customers and lease you the equipment. You do the work and reap anticipated rewards of $17,000 in first year. You have a guaranteed area, and we guarantee most of your income.
For confidential interview phone Accent Services 159 Adelaide-tce 3252455.

BUS. PARTNERSHIPS

AAA

$3500

Is all you need to own your own business. We supply the customers, and lease you the equipment. You do the work and reap anticipated rewards of $17,000 in first year. You have a guaranteed area, and we guarantee most of your income.
For confidential interview phone Accent Services 159 Adelaide-tce 3252455.

REAL ESTATE

AAA

$3500

Is all you need to own your own business. We supply the customers and lease you the equipment. You do the work and reap anticipated rewards of $17,000 in first year. You have a guaranteed area, and we guarantee most of your income.
For confidential interview phone Accent Services 159 Adelaide-tce 3252455.

AAA

$3500

Is all you need to own your own business. We supply the customers and lease you the equipment. You do the work and reap anticipated rewards of $17,000 in first year. You have a guaranteed area, and we guarantee most of your income.
For confidential interview phone Accent Services 159 Adelaide-tce 3252455.

Attachment "B"

The Colourshot Advertisements

See Commentary **Part V** of Text

JOIN THE COLOURSHOT TEAM

and increase your business

Adelaide Address

58 King William Road,
Goodwood. 5034.

If you want to become a COLOURSHOT agent ring

[03] 267 5733
[08] 272 9577
[03] 267 5998
[03] 267 5298

COLOURSHOT
High quality colour film processing and print service
434 St. Kilda Road. Melbourne. 3004.

How Colourshot can help you increase your turnover.

What is Colourshot?

Colourshot is a well-established, national organisation dealing solely in colour film processing.

In the past this lucrative industry has been restricted to the pharmacist and the specialty camera store. Colourshot has changed all that and opened up what is one of Australia's fastest growing industries to enable you, the retailer to take advantage of this offer.

Here is a unique opportunity for you to increase your custom, increase the range of services you can offer, and earn extra money at the same time.

Colourshot Head Office

2nd Floor, 434 St. Kilda Road,
Melbourne 3004.
Tel: (03) 267 5733.
267 5998, 267 5298

Bankers

CBC Bank,
409 St. Kilda Road,
Melbourne Vic. 3004
Tel: (03) 26 2122

CBC Bank,
66 King William Road,
Goodwood S.A. 5034
Tel: (08) 513 261

Solicitors

Colquhoun and Colquhoun,
Darling Street, Rozelle.
N.S.W. 2039.
Tel: (02) 82 0674
Attention:
Contact
Peter Erickson,
Reilly Ahern & Kerin,
153 Flinders Street,
Adelaide. 5000.
Tel: (08) 223 2124

Here's all you do:

Being a Colourshot Agent simply means that you act as a collection point for colour film to be processed. When customers leave their film, you simply hand them a receipt from the pad we provide. Our representative will call daily to pick up new film and deliver processed stock. Customers pay cash when the film is picked up and the amount is shown at the botton of the delivery envelope. You retain $1.00 per roll of film processed and 10% of the cost of print enlarging or print re-orders and hand the balance over to the Colourshot representative on a fortnightly basis. You are indemnified against any financial loss incurred on uncollected films - simply hand them over to the Colourshot representative after four weeks.

No Investment

No buying, selling or capital outlay is incurred. A Colourshot Agent is purely a collection point for colour film to be processed.

No Mailing, No Travelling

Your local Colourshot representative will handle all pick-up and delivery services on a daily basis.

Instant Return

As soon as the customer picks up and pays for the film, you earn $1.00 per roll commission (normal processing time is between one and two days). Furthermore you have another 14 days to pay the balance to the Colourshot representative. Our figures show that after the establishing period, the average income of a Colourshot Agent is between $150-$200 per month.

Sales Aids

On becoming a Colourshot agent we provide you, free of charge, with six months supply of sales promotion aids including window stickers, customer leaflets and of course, receipt pads and envelopes for the film.

Increased Business

Being a Colourshot Agent means that not only will you give a wider service to your present customers, you will also increase your income and customer traffic through your establishment.

BECOME A COLOURSHOT AGENT AND JOIN ONE OF THE MOST LUCRATIVE INDUSTRIES IN AUSTRALIA

Attachment "C"

Definition of Franchise Agreement [as prescribed in the Franchising Code of Conduct] and the Application of the Code

See Commentary **Part VII** of Text

Franchise Agreement

4. (1) A franchise agreement is an agreement:

(a) that takes the form, in whole or part, of any of the following:
  (i) a written agreement;
  (ii) an oral agreement;
  (iii) an implied agreement; and

(b) in which a person (the franchisor) grants to another person (the franchisee) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and

(c) under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol:
  (i) owned, used or licensed by the franchisor or an associate of the franchisor; or
  (ii) specified by the franchisor or an associate of the franchisor; and

(d) under which, before starting business or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount including, for example:
  (i) an initial capital investment fee; or
  (ii) a payment for goods or services; or
  (iii) a fee based on a percentage of gross or net income whether or not called a royalty or franchise service fee; or
  (iv) a training fee or training school fee;
  but excluding:
  (v) payment for goods or services at or below their wholesale price; or
  (vi) repayment by the franchisee of a loan from the franchisor; or
  (vii) payment for the wholesale price of goods taken on consignment; or

(viii) payment of market value for purchase or lease of real property, fixtures, equipment or supplies needed to start business or to continue business under the franchise agreement.

(2) For subclause (1), each of the following is to be taken to be a franchise agreement:

(a) transfer, renewal or extension of a franchise agreement;

(b) a motor vehicle dealership agreement.

(3) However, any of the following do not in themselves constitute a franchise agreement:

(a) an employer and employee relationship;

(b) a partnership relationship;

(c) a landlord and tenant relationship;

(d) a mortgagor and mortgagee relationship;

(e) a lender and borrower relationship;

(f) the relationship between the members of a co-operative that is registered, incorporated or formed under any (State or Territory Co-operatives legislation) [Statutory details are set out in full in the Code but are not here reproduced.]

Application

5. (1) This code applies to a franchise agreement entered into on or after 1 October 1998.

(2) For the parties to a franchise agreement entered into before 1 October 1998:

(a) clauses 14 (Copy of lease),
15 (Association of franchisees) and
17 (Marketing and other co-operative funds)
applies to the parties on and after 1 July 1998.

(b) the rest of this code applies to the parties on and after 1 October 1998.

(3) However, this code does not apply to a franchise agreement:

(a) if the franchisor:
(i) is resident, domiciled or incorporated outside Australia;

and

(ii) grants only 1 franchise or master franchise to be operated in Australia; or

(b) to which another mandatory industry code, prescribed under section 51AE of the Act, applies;[80] or

(c) if:

(i) the franchise agreement is for goods and services that are substantially the same as those supplied by the franchisee before entering into a franchise agreement; and

(ii) the franchisee has supplied those goods or services for at least 2 years immediately before entering into the franchise agreement ; and

(iii) sales under the franchise are likely to provide no more than 20% of the franchisee's gross turnover for goods or services of that kind for the first year of the franchise.

(4) Paragraph 3(c) ceases to apply to a franchise agreement if:

(a) sales under the franchise provide more than 20% of the franchisee's gross turnover for the goods or services for 3 consecutive years; and

(b) the franchisee tells the franchisor that paragraph (a) applies.