

## SOUTH AUSTRALIAN FRANCHISE REFORM: WARNING SHOT OR DECLARATION OF WAR?

On the 3<sup>rd</sup> December, 2009, the last sitting day of the South Australian Parliament for the year (and before next year's State election) Mr Tony Piccolo, the Member for Light, introduced a Private Member's Bill proposing a South Australian Franchising Law that modifies the existing Commonwealth regulations.

The proposed SA Bill is a slap in the face to Federal Minister Dr. Craig Emerson's recently announced amendments to the Franchising Code of Conduct which in the opinion of Mr. Piccolo were "...a positive step but highly inadequate".

### BACKGROUND

The franchising industry has undergone 3 separate inquiries over the last 3 years; by the Western Australian government, the South Australian Government (in which Mr Piccolo participated) and also by the Senate Parliamentary Joint Committee on Corporations and Financial Services, whose report was presented to the Federal Government on 1 December, 2008. All inquiries raised significant areas of concern in the industry and the Senate Committee made 11 recommendations to improve the outcomes of participants in the sector.

In November, 2009 the Federal Government announced it would implement some, but not all, of the Senate recommendations, most notably refusing to legislate that franchisors and franchisees were required to act "in good faith" in their dealings with each other.

The issue of "good faith", together with the creation of a franchising Commissioner and the introduction of pecuniary penalties for breaches, are the feature points of the South Australian Bill and unsurprisingly the issues that create the most controversy with Mr Piccolo's opponents.

All parties in this debate agree on one point: State based franchising laws are not the ideal solution. So why has Mr Piccolo concluded that a second best option is better than the package put forward by the Federal Government?

A quick review of some of the recommendations of the Senate Committee is helpful:

#### [Recommendation 2](#)

The Government investigate the benefits of developing a simple online registration system for Australian franchisors, requiring them on an annual basis to lodge a statement confirming the nature and extent of their franchising network and providing a guarantee that they are meeting their obligations under the Code and the *Trade Practices Act 1974*.

#### [Recommendation 7](#)

The Government require the Australian Bureau of Statistics to develop mechanisms for collecting and publishing relevant statistics on the franchising sector.

### **Good faith in franchising**

The Committee believed that the best way to provide a deterrent against opportunistic conduct in the franchising sector is to explicitly incorporate the existing and widely accepted implied duty of parties to a franchise agreement to act in good faith.

#### **Recommendation 8**

The following new clause be inserted into the Code:

#### **6 Standard of Conduct**

*Franchisors, franchisees and prospective franchisees shall act in good faith in relation to all aspects of a franchise agreement.*

#### **Enforcement of the Code**

Many franchisees made submissions to the inquiry outlining perceived inaction by, and ineffectiveness of, the Australian Competition and Consumer Commission (ACCC) in pursuing complaints against franchisors alleged to be in breach of the Code. Notwithstanding the limitations of the ACCC's role, there seems to be room for improvement by the regulator in taking a more active role in the franchising sector.

#### **Recommendation 9**

The *Trade Practices Act* 1974 be amended to include pecuniary penalties for breaches of the Code.

#### **Recommendation 10**

The introduction of pecuniary penalties for breaches of section 51AC, section 52, and the other mandatory industry codes under section 51AD of the *Trade Practices Act* 1974.

#### **Recommendation 11**

Greater freedom for the ACCC to investigate based on credible information indicating that a party to a franchising agreement may be engaging in conduct contrary to their obligations under the Code.

These recommendations were not fully adopted into the November, 2009 amendments made by the Federal Minister. Although the issue of "good faith" was noted it was only to the extent that nothing in the Franchising Code of Conduct limits any common law requirement of good faith in relation to a franchise agreement.

It can be readily seen that the SA Bill seeks to implement some of the major recommendations of the Senate Committee disregarded by the Federal Government and are not novel issues in and of themselves.

### "GOOD FAITH"

The concept of "good faith" is one that, on its surface, seems fair enough but its detractors, including the Franchising Council of Australia (FCA), maintain that the inclusion of such a term is unnecessary and will be to the detriment of the franchising sector.

In responding to Mr Piccolo's introduction of the SA Bill, Mr Steven Wright, the Executive Director of the FCA said:

“The FCA made it clear to Mr Piccolo it would provide extensive background, information and compelling argument as to why it was opposed to his regressive proposal. Mr Piccolo decided not to wait for any such information”.

“Apparently Mr Piccolo thinks he knows better than Ministers from Canberra and around the country, who have rejected the idea.

To suggest that such a move would increase efficiency beggars belief. On the contrary, it will directly increase compliance costs and create a clear disincentive to franchise investment in SA.

Hopefully it will be buried with the poll and its like will never be seen again in SA, or any other State.”

“The FCA will continue its work with Government and Opposition MPs to ditch Mr Piccolo’s dead weight proposal”.

Whether the FCA has any real evidence to support its position, having failed to put a compelling case before the Senate Committee, remains to be seen. Its main argument appears to be that good faith sets a standard that is so subjective that litigation is the only way that such an allegation can be resolved, leading to an increase in Court cases.

Unfortunately for the FCA, an increase in Court cases is precisely what would assist in clarifying the current ‘unconscionable conduct’ laws, which have suffered from a lack of detailed consideration by the Courts. As noted by the Senate Committee, litigation is beyond the reach of many franchisees and to argue a point of law that is currently unclear is a major risk particularly when there are no assurances of success – hence the lack of legal precedent.

In introducing an explicit requirement of good faith, the SA Bill seeks to regulate the standard of behaviour of franchising businesses in a way not considered necessary under the Franchising Code of Conduct. Mr Piccolo adopts a definition of “acting fairly, honestly, reasonably and in a co-operative manner” for the concept of “good faith”.

Such a standard is certainly subjective and some franchising lawyers are concerned that a franchisor (especially) may be backed into an impossible corner – such as a situation where their conduct to protect the legitimate interests of their system or network will result in detriment being suffered by a minority of their franchisees. The question then has to be asked – how does a concept of acting in “good faith” (using Mr Piccolo’s definition) – correspond to the sometimes harsh realities of business?

More importantly perhaps, who decides the issue?

#### FRANCHISING COMMISSIONER

The most confronting element of the SA Bill is not so much the introduction of a franchising Commissioner, but the extensive powers delegated under the Bill.

The Commissioner, a public servant who may delegate their powers, will have the ability under the SA Bill to:

- Require a person to answer questions or to produce documents (with a potential \$20,000 fine applying to a failure);
- Require a person to give such information under oath;
- Require a person to provide such information regardless of whether the information would tend to incriminate the person or expose them to a penalty; and
- Commence legal proceedings for breaches of the SA Franchise Law.

The only other organisations in Australia with powers even remotely similar are corruption commissions and intelligence services. Is franchising in such a dire state that powers similar to those claimed necessary to prevent terrorism are necessary? (As an interesting aside, could the Hells Angels, for example, be regarded as a franchise caught under the SA Bill? One wonders...).

But that is not the full extent of the powers granted under the SA Bill - the Commissioner will provide a dispute resolution function as well; if a franchise dispute cannot be resolved by mediation, either party may refer the dispute to the Commissioner for determination .

A conference must then be called between the parties, facilitated by the Commissioner, following which (if a resolution is not reached) the Commissioner will provide the parties with a *draft determination*. Within 14 days of receiving the draft determination the parties may make written representation why the draft determination should be varied or confirmed.

After considering any written representations the Commissioner must make a final determination of the dispute by varying or confirming the draft determination *as the Commissioner thinks fit*. The parties are then *bound* by the final determination – and the Commissioner or the other party can apply to the District Court for orders enforcing the terms of the determination.

There is no right to legal representation in the dispute resolution process although it may be available in certain circumstances.

There does not appear to be any right of appeal against the final determination of the Commissioner.

Although the Senate Committee clearly recognised the need for improvements to dispute resolution processes and there is ample argument to support a low cost, practical approach when dealing with minor disputes, potentially leaving the parties without legal representation in arguments *of law* (arguments that are currently not making their way before the civil Courts and are very technical by nature) appears to far exceed what was contemplated by the Committee.

A further unexplained dynamic is how the ACCC – the regulator of the sector – would interact with the Commissioner’s determinative powers. The outcomes of disputes that are *determined* by the Commissioner before the ACCC took action under its own investigative and prosecutory powers are unclear.

#### PECUNIARY PENALTIES

The SA Bill artfully adopts the Franchising Code of Conduct (and as it is amended from time to time) and gives it power as a State Law. The opportunity then arises to impose penalties for failure to comply with the Code that the Federal Government shied away from implementing.

The Franchising Code currently carries no fines for breaching its requirements. The most recent changes flagged by the Federal Government include a provision that financial penalties may apply to certain breaches of the Trade Practices Act that interact closely with the Franchising Code (including unconscionable, misleading or deceptive, conduct).

Under the SA Bill if the District Court is satisfied that a person has contravened the SA Franchising Law, or has attempted to contravene (or aided, abetted, procured, counselled, induced or been in any way, directly or indirectly, knowingly involved in contravening) the Law, the Court may impose penalties of up to \$100,000 for corporations or \$10,000 for individuals.

Injunctive relief (presumably pursuant to the usual rules of Court) is also available.

As a contravention of the SA Franchising Law would necessarily include a failure to comply with a final determination of the Commissioner, even a 'minor' breach could result in very nasty consequences indeed. This seems to be an intended outcome to penalise 'rogue franchisors' (an undefined term) that the Federal Government is also attempting to control through its amendments.

The District Court can also make awards of compensation as a result of a breach of the SA Franchising Law. An application for compensation can be made by an affected party – or by the Commissioner.

#### FRANCHISE REGISTER

The Senate Committee recognised the need for further statistical data in relation to franchising matters, especially with regard to franchising disputes:

“Due to a lack of sound data, the true extent of disputation in the franchising sector is difficult to determine”.

As a result the true state of the franchising sector is impossible to determine with accuracy; a sector that was *estimated* to have a turnover of \$130 billion in 2007. In truth, no one knows how many franchise systems operate in the country or how many franchisees exist. Neither is there any definitive information regarding how many franchisors or franchisees survive (or fail) from year to year. There is definitely a need for such data before any pronouncement on the health of the sector can be made with any confidence.

The SA Bill seeks to remedy this lack of data by creating a register for relevant franchise information.

The Commissioner will be required to establish a register that includes the details of any franchisor who is found to have contravened the SA Franchising Law but, somewhat more disturbingly, includes *any other matter that, in the opinion of the Commissioner, should be recorded in the register.*

The register is to be made available on line as well as in hard copy able to be inspected within office hours.

Not only will the Commissioner wield plenipotentiary powers to compel the production of information and the determination of disputes, a public register is to be maintained that may contain all such information that the Commissioner does not consider to be 'confidential'.

This would have to be one of the areas that Mr Piccolo concedes will be the subject of further stakeholder feedback leading to a revision of the Bill before it is reintroduced to Parliament.

## CONCLUSION

The terms of the SA Bill, while essentially attempting to implement those recommendations of the Senate Inquiry considered most important by Mr Piccolo, goes well beyond what could be considered reasonable to address the concerns highlighted by the Committee.

The FCA contends that the SA Bill will make South Australia a franchising wasteland (somehow coming to the conclusion that the costs of compliance will deter franchisors, although no extra costs seem to be required under the Bill) while others regard the Bill as an oasis in a franchising desert otherwise devoid of hope. The reality will lie somewhere in between, however if it does nothing else the SA Bill highlights the ongoing need for genuine reform in the franchising sector.

The timing of the introduction of the Bill, the fact that a State election will intervene before it is again presented to the SA State Parliament and the explicit recognition that further debate leading to modifications to the Bill are likely leads to the obvious conclusion that the SA Bill is intended as a warning to the Federal Government that its attempt to water down the Senate Committee's recommendations has not worked.

The remaining question is whether the Federal Government will take the warning seriously. The Minister's track record is not encouraging in this regard and with only a few months to consider an embarrassing about face the Minister might put the pressure back on Mr Piccolo to make good on his stated intention to re-introduce the Bill.

Mr Piccolo claims the support of the South Australian Premier for the Bill, which on the face of things makes it difficult to dismiss out of hand. Time will tell whether there is support for a Bill that splinters the framework of standardised national business regulation.

Only two things appear certain at this point - the first is that the SA Bill as it is presently constructed does not pass muster (but the ensuing debate it generates is intentional ) and second, Mr Piccolo's electoral opponents in the forthcoming election are likely to be well funded.