

  <p>Australian Competition &amp; Consumer Commission</p>	<p><b>National Franchising Conference 2010 Surfers Paradise, Queensland</b></p> <p><b><i>Enforcements and Audits – the ACCC’s Plans and Intentions</i></b></p> <p><b>Dr Michael Schaper, Deputy Chair, ACCC</b></p> <p><b>Sunday, 10 October 2010</b></p>
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## **Introduction**

Thank you for the invitation to be with you today.

Today I'd like to briefly re-cap the recent amendments to the Franchising Code, explain the Australian Competition and Consumer Commission's (ACCC's) enforcement powers as they relate to franchising, give you some examples of where we have used these powers, and leave you with some thoughts on what the ACCC looks for when regulating the Franchising sector.

Now normally at this point I'd give an overview of Franchising in Australia as a prelude to the Franchising Code of Conduct. But given our audience today and the time we have available I'm going to get right into it.

Suffice it to say that franchising will continue to be a very popular business model in Australia. Therefore, it is important that franchisees and franchisors, and those advising the sector make certain they learn as much as they can about the ins and outs of franchising.

## Overview of Updates to Franchising Code of Conduct

The ACCC regulates franchise relationships through the Franchising Code of Conduct, which is a mandatory code of conduct in the *Trade Practices Act (1974)*.

The code ensures franchisees receive certain information about a franchise before, and after, entering into it. The code also provides a dispute resolution scheme if conflict does arise.

In addition to the code, both franchisees and franchisors are also subject to the competition and consumer protection provisions of the Act, like any other business large or small.

The new amendments to the Franchising Code require franchisors to provide additional information to prospective franchisees to help with their due diligence.

Changes to the franchising code apply to new agreements and existing agreements that are transferred, renewed or extended after 1 July 2010.

Details of the recent amendments are in the ACCC's Fact Sheet on the amendments, and are captured in the updated Franchisee manual. All of these are on the franchising area of our website at [www.accc.gov.au/franchising](http://www.accc.gov.au/franchising).

Franchisors are required to provide prospective franchisees with a disclosure document at least 14 days before entering into a new agreement. In addition to the information previously required, a disclosure document must now also include:

- a notice acknowledging that the franchise or franchisor could fail

- details of any payments by the franchisee to any third parties, known or reasonably foreseeable
- if there will be a requirement for significant capital expenditure
- if the franchisor's dispute resolution costs will be passed on to the franchisee
- whether a confidentiality agreement will be required and what it will cover
- If in the past there has been any unilateral variations of the franchise agreement, or the circumstances in which an agreement may be unilaterally varied in the future
- arrangements that will apply at the end of the franchising agreement, including whether the franchisee will have an option to renew the agreement or enter into a new one, and whether they can sell the business or get an exit payment.

In addition to the end of agreement disclosures, a franchisor must now notify a franchisee, at least six months before the contract comes to an end, of its decision about contract renewal or if a new contract will be entered into.

For contracts under six months, one month's notice is required.

This is important because when an agreement concludes, franchisees lose the right to use the franchisor's brand and operating system. Most franchise agreements will also prevent the franchisee from setting up a similar business under a different name.

The franchisor must provide an accurate disclosure document to both current and prospective franchisees.

The code also requires a franchisor to notify franchisees of certain materially relevant facts—such as majority ownership changes—within 14 days.

The code changes should help improve due diligence and communication flow. These factors are often significant in disputes. However if a dispute arises, the code provides a mechanism for parties to resolve the dispute through mediation.

The code now requires that both parties must try to solve disputes in a reconciliatory manner, including by making their intentions clear at the outset and not damaging the reputation of the franchise system during the dispute.

The code sets out the expectations of parties in this process and says that each party is equally liable for the costs of mediation, unless they agree otherwise.

It is fair to say that dispute resolution is usually not on the radar of prospective franchisees.

However in the long run, their understanding of the dispute resolution processes available may assist in managing and potentially resolving conflicts if they do arise.

If dispute resolution fails, either party may ask the Office of the Franchising Mediation Adviser to appoint a mediator.

Court action should be regarded as a last resort. It can be costly, time consuming and often can lead to further fracturing of the franchising relationship. There is also no guarantee that either party will win.

It must be noted that ACCC can not take action for breaches of the franchising agreement, because this is a contractual issue between franchisees and franchisors.

However as the national regulator, the ACCC has and will continue to investigate complaints about breaches of the code and *Trade Practices Act* and where necessary will take enforcement action.

## **New Enforcement Powers**

There have been some significant changes to the Act this year, with further changes to come on 1 January.

This will include a renaming of the *Trade Practices Act* (1974) to the *Competition and Consumer Act* (2010).

The ACCC's new powers under reforms in effect since mid-April include civil pecuniary penalties for part V conduct, Substantiation Notice powers, Infringement Notices, the power to issue Public Warning Notices to protect consumers, disqualification orders, and non party consumer redress powers.

There will also be a range of powers that come into effect next January, but let me first explain how the ACCC sees its current crop of 'new' powers.

Civil pecuniary penalties, although not available for breaches of the Code, help the ACCC bridge the gap between the civil measures for breaches of consumer protection provisions, and the criminal penalty provisions.

The ACCC can issue a substantiation notice requiring a person to provide information or documents that substantiate claims or representations.

These can be used as a preliminary investigative tool where the ACCC suspects a representation may not be able to be substantiated and subsequently in breach of the consumer protection laws.

For example a substantiation notice may be issued where the ACCC has concerns about "two part", or "was/now", advertising.

Or in relation to new franchising agreements claims about projected earnings.

The recipient of a substantiation notice has 21 days to respond. Failure to comply with the notice may result in the ACCC seeking an order for a pecuniary penalty or issuing an infringement notice.

Infringement notices provide the ACCC with an additional tool to encourage and enforce compliance with the *Trade Practices Act*. We've found that they provide a swift resolution to encourage compliance in cases where a business has shown a reluctance to comply without suitable incentive.

If a business pays an infringement notice, the ACCC is precluded from taking further action in respect of that alleged contravention. Infringement notice penalties are \$6600 for corporations and \$1320 for individuals.

The ACCC has already issued a number of infringement notices. One example is in relation to the component pricing laws as they relate to restaurant menus.

The ACCC has been working with the hospitality sector over the past 18 months to educate outlets about these transparent pricing obligations, providing education material, working through professional associations and visiting cafes and restaurants on the ground.

Following the education efforts we began to warn businesses who did not comply, giving them a fair time to change their practices.

Those who ignored the warnings were issued infringement notices. Most paid. Those who didn't now face court action.

In the context of franchising an infringement notice may be issued where the matter is considered to be minor.

For example where a franchisor makes a false representation to a prospective franchisee before they enter into a franchise agreement, but the franchisee suffers little harm as a result of the representation.

There are now consistent nationwide powers for regulators to issue warning notices to the public.

At times in consumer-market regulation, a rapid warning to the public is the best way of delivering protection. The ACCC remains mindful of using this power with appropriate consideration and safeguards.

The ACCC is likely to issue a Public Warning Notice where a director or a franchisor is a serial re-offender, committing serious breaches of the Act on multiple occasions, and showing a blatant disregard for the law. From 1 January next year this power will be able to be exercised for breaches of the Franchising code.

The ACCC issued its first Public Warning Notice at the end of August. This was against a firm whose conduct was considered so egregious and ongoing, despite ACCC action, as to warrant this kind of public naming and shaming.

This warning was not about a franchising matter, but it does indicate the ACCC's willingness to use this tool to protect consumers.

Disqualification orders will restrict individuals from managing corporations where the Court is satisfied those individuals should be prevented from such roles. The ACCC will seek to apply these powers where an individual has been involved in repeated instances of trade practices misconduct.

And lastly among these new powers is third party redress. The ACCC will also have the ability to seek orders from

the court to provide redress for franchisees who are not parties to particular legal action.

This power currently applies for breaches of the specific provisions of the Act, and from 1 January for breaches of the code. This will be relevant where, for example, a franchisor breaches the Franchising Code, and this causes a number of franchisees to suffer loss or damage. The court will be more readily able to remedy those losses.

### **Further reforms and powers**

Further reforms will come into effect on 01 January next year. As well as the extensions to public warning powers and third party redress for breaches of the Franchising Code I have already mentioned, the ACCC is gaining a new investigation power – known as the random audit power.

### **New audit power**

The new investigation power which will allow us to audit franchisors for compliance with the Code.

The ACCC will be able to compel a franchisor to provide information or produce documents or records that it is required to keep, generate or publish under the Code. This information must be provided to the ACCC within 21 days.

This investigation power will assist the ACCC in situations where there are significant imbalances in bargaining power between industry participants. Often in these circumstances, less powerful participants are hesitant to report contraventions by more powerful participants, for fear of retaliatory action.

Thus the random audit power will help strengthen franchisor compliance with the Code, while relieving



franchisees of the fear of retaliation against them for complaining to the ACCC about franchisor behaviour.

It will also allow the ACCC to monitor compliance in the franchising sector without relying on complaints by other industry participants.

The ACCC will use this power to obtain a range of documents from franchisors, including disclosure documents, franchise agreements, professional advice statements and marketing fund accounts.

Using this information we will quickly be able to determine whether franchisors are complying with the Code.

So a very important message here is to keep your records and documents up to date. The ACCC will be able to issue notices at any time.

The ACCC will also be able to use the random audit power in conjunction with other powers. So, for example, where a substantiation notice has been issued and a franchisor does not comply with the notice.

It could also be used to verify any information, documents or evidence provided by a franchisor to substantiate claims or representations made.

The 'random audit' powers are different from the ACCC's formal information gathering powers under Section 155 of the Trade Practices Act. Section 155 powers are limited in that the ACCC must have a 'reason to believe'.

The investigation power is not subject to such a limitation, and so could be used, together with substantiation notice powers, if necessary, to obtain documents and other information.

As you would expect, if you receive a 'random audit' request, or a Section 155 notice, you must not give the

ACCC false or misleading information or documents. Our existing civil remedies apply in these circumstances.

## **Breaches of the Franchising Code of Conduct**

The ACCC has recently had a number of enforcement actions for breaches of the Franchising Code.

For example, recently the ACCC secured court-enforceable undertakings against real estate agent Ray White for terminating a franchise without giving reasons to the franchisee or providing them an opportunity to remedy any breaches. This conduct was in contravention of the Franchising Code.

The ACCC also took action against Seal-A-Fridge for unconscionable conduct against its franchisees and breaching the code.

Seal-A-Fridge a franchisor of a mobile refrigeration seal replacement business, withheld access to its national telephone number to franchisees that did not agree to vary their franchise agreements and pay a 50 per cent fee increase for the telephone service.

The court granted injunctions against Seal-A-Fridge and its director.

ACCC action resulted in franchisees of telephone retailer Allphones collectively receiving \$3 million in damages.

Allphones was found to have engaged in unconscionable conduct for bullying franchisees that did not come into line with their demands. Bullying tactics included withholding stock and income and threatening franchisees with breach notices.

The court also declared that Allphones had engaged in misleading and deceptive conduct towards franchisees in

masking commissions and bonuses it received from suppliers.

## **The ACCC Philosophy in Franchising Regulation**

So the question I'm sure many of you are wanting answered is: how will the ACCC use our new powers?

Well, we will continue compliance and enforcement in line with our priorities. In deciding which compliance or enforcement tool to use, the first priority will always be to achieve the best possible outcome for the community.

In line with the compliance pyramid model, the ACCC firstly makes comprehensive use of educational campaigns to provide information and advice and to use persuasion to encourage compliance with the Act.

The ACCC takes the firm view that prevention of a breach of the *Trade Practices Act* is always preferable to taking action after a breach has occurred.

So education, liaison with industry to achieve voluntary compliance is the basis of our enforcement and compliance pyramid.

In some cases the ACCC may use non-court based action including accepting an administrative resolution.

For example, administrative resolutions may be used to address minor breaches. We may issue infringement notices to resolve issues quickly, or use public warning powers for those who show a blatant disregard for the law. We are aware these can potentially be damaging to a business.

And of course court-enforceable undertakings, may be used for more serious and particularly egregious contraventions.

Litigation, at the apex of the compliance pyramid, taken where, having regard to all the circumstances, the ACCC considers litigation is the most appropriate way to achieve its enforcement and compliance objectives.

However I am pleased to say that compliance with the code and Act is generally quite high.

To keep it high as we move into a changing regulatory environment, franchisees should:

- a. Make sure you keep good records, updating them regularly.
- b. Make sure your disclosure documents are updated each year.

## **Conclusion**

The ACCC is the competition regulator. We are here to protect competition, not competitors.

The ACCC does not exist to protect individual businesses, franchisees may still fail.

The ACCC's vigorous policing of laws combined with the information and open disclosure encapsulated in the changes to the franchising code, encourages informed consumers, and competitors.

Open, free and fair markets are the best way for competition and competitors to flourish.

The amendments to the franchising Code of Conduct, backed by the ACCC's new powers to enforce these changes provide for more effective information flow between franchisors and franchisees.

Just as there are new enforcement powers for the ACCC – with the changes to the franchising code, these new

obligations will, if met, help reduce issues in the sector and help more franchisees be successful in their business.

Thank you.

I'd now like to open the floor to some questions.