

 	<p>Franchise Council of Australia National Convention</p> <p>Melbourne, 10 October 2011</p> <p><i>The franchising sector and the ACCC</i></p> <p>Rod Sims Chairman</p> <p>Australian Competition & Consumer Commission</p>
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Introduction

Thank you Stephen.

I am delighted to be here this morning particularly so as I believe it is the first time in almost a decade that an ACCC Chairman has addressed the franchising community.

My Deputy Chairman, Dr Michael Schaper, has however been a regular presenter at FCA events and he presented in detail on the new audit powers at your legal symposium yesterday. I would like to publicly thank Michael for all his excellent work in this and other areas.

Like most Australians I know a number of people who have been franchisees. I have, therefore, observed close up how this sector works, its strengths and what some of the many pitfalls can be. In particular, I have observed both the early promise and, in some cases, the unfortunate reality.

Today I want to make just three points:

- First, while the franchising sector is an important part of our economy, it does some image issues.
- Second, the ACCC has an important role in relation to franchising, but there is also much that is outside our jurisdiction.
- Third, and most important, the ACCC will be doing more, and earlier, to achieve industry compliance.

1. Franchising is an important sector, but it does have some image issues

The franchising sector is an important part of the Australian economy. In 2009 the total sales turnover for the sector was estimated at \$128 billion. In 2010 there were just over 1000 franchisors, with close to 70,000 outlets across Australia.

So it's a successful and healthy part of the business community and, as those figures highlight, a popular business model.

And while there has been a modest downturn in the franchising sector over the previous year – particularly in retail, not surprisingly – the average number of franchise units owned by individual franchisors has grown.

Unfortunately, though, the sector has at times suffered from a poor image. Indeed, in many ways its strengths are also its weaknesses. Franchising is young, dynamic and offers an opportunity for real entrepreneurship. It therefore can attract people who like the ease of entry and respond well to an environment with few rules.

As many of you know, references to unfair practices in franchising systems were the subject of a review as far back as 1976, with the Swanson Committee.

The sector was again reviewed three years later, then again in 1990, which led to the introduction of a *voluntary* franchising code of conduct, and yet a fourth time in 1997.

That's four major reviews of an industry in just over 20 years.

It was this final review that led to the introduction in 1998 of the *mandatory* Franchising Code of Conduct, which does indicate that there has been an awareness of the challenges in franchising for many years.

The ACCC's complaints data supports the proposition that there are problems in the sector.

In the last financial year the ACCC received just over 600 franchise-related complaints.

- 28 per cent of those complaints included allegations of misleading and deceptive conduct; for example, misleading claims about potential earnings
- 15 per cent included allegations of failure to provide adequate disclosure as required by the code
- 14 per cent included allegations of unconscionable conduct by the franchisors
- 11 per cent related to allegations of the unlawful termination by the franchisor of the franchising agreement.

As the Chairman of the ACCC, it is difficult for me to ignore these statistics.

These complaints resulted in a number of ACCC investigations, administrative resolutions and a number of prominent cases against franchisors.

- We took action against mobile refrigeration business Seal-A-Fridge for unconscionable conduct against its franchisees and breaching the code. The franchisor 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 pressurising franchisees that did not fall into line with their demands. The pressurising 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.

- And 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.

A particular cause of these problems is that Franchisors are often large and well-resourced companies that hold substantial power in the franchising relationship. They coordinate the operations, they own the brand and, in many cases, they control the supply of the key products for the franchising business.

On the other side of the equation, franchisees are often couples or individuals, many of whom enter the franchising relationship without a great deal of business experience, but nevertheless invest large sums of money (and sometimes their nest egg) to buy into and be part of a franchise. They often invest the money without doing sufficient due diligence checks.

This can make franchisees vulnerable and this inherent imbalance in power is open to abuse.

The continuation of some dubious practices in the franchising sector harms franchisors as well as franchisees. Ultimately it will make potential franchisees think twice about entering the industry; it will make consumers less likely to deal with franchisees; and it will see more calls for government action.

It is in the interests of franchisors to improve the image of franchising. That is, to make sure potential franchisees have access to all the relevant information and fully understand what their rights are before they commit to your franchise system.

2. The ACCC's role

Like all businesses, franchisors and franchisees have a range of obligations under the Competition and Consumer Act.

These obligations are wide-ranging, such as prohibitions against misleading and deceptive conduct and unconscionable conduct under the Australian Consumer Law, and prohibitions against anti-competitive conduct under Part IV of the Act.

The ACL provides for substantial court-imposed civil penalties against corporations and individuals who engage in unfair practices or deceptive conduct in marketing franchise arrangements.

The ACCC can issue a substantiation notice requiring a person to provide information or documents that substantiate claims or representations. For example, a substantiation notice may be issued where the ACCC has concerns about claims of projected earnings.

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

As I have just mentioned, franchisors and franchisees have an additional layer of regulation imposed upon them by the Franchising Code of Conduct, which the ACCC also enforces.

The mandatory code of conduct principally addresses disclosure of information. It imposes:

- obligations on the franchisor to disclose certain documents to the franchisee prior to entering into the franchise agreement
- a cooling off period
- certain requirements that must be met before the franchising agreement can be terminated.

It also forces franchisors and franchisees to attend mediation to resolve disputes.

When we pursue franchisors for breaches of the code, in many cases the problems are able to be remedied through an administrative resolution, such as an exchange of letters that recognise a problem, or by the franchisor providing section 87B court enforceable undertakings.

This usually means franchisors are given a process whereby they can change their behaviour, without going to court, to ensure they comply with the code in future.

In serious cases, or where franchisors do not cooperate, the ACCC can proceed to court to seek appropriate injunctions and other remedies.

We do, of course, help complainants understand their rights under the code so they know how to gain access to the dispute resolution process within it and how to instigate a compulsory mediation.

It is important to note that what we do not do is settle purely commercial disputes between franchisors and franchisees, such as contract disputes. Our role is to enforce compliance with the Act and the code. In essence, we are an enforcement agency, not a mediator.

We do, however, inform people of the service offered by the government-funded Office of Franchising Mediation Adviser to assist with the appointment of a mediator.

Further options are available in some jurisdictions, such as the recently created Office of the Victorian Small Business Commissioner and the new Small Business Commissioners in Western Australia and NSW who offer low-cost, informal and confidential mediation services.

I note that South Australia is also looking to appoint a small business commissioner.

I would urge all franchisors to consider referring franchising disputes to mediation as early as possible, even if it means arranging a private mediation outside of the systems I have just referred to.

If franchising parties stop talking to each other or if they resist attempts by the other party to arrange mediation, inevitably the dispute will escalate to a point of no return.

Early intervention, on the other hand, means you have best possible chance of restoring the relationship to where it should be, so that the problems can be resolved and all parties can get on with the business of running the franchise and making money.

3. We will be doing more – and earlier – to achieve industry compliance

My main point today is that the ACCC would like to help the franchising sector improve its image.

To do this, it is important that we – the ACCC – do more to enforce the code of conduct and the Competition and Consumer Act. And it is crucial that we act early and make an assessment to determine what if any intervention is required.

One important area where we could do more is in relation to the information provided to franchisees in relation to their likely earnings. We can perhaps look more closely to see where franchisees have been misled, and pursue pecuniary penalties and other remedies. Improvements in this area alone would greatly improve the reputation of franchising, and it's an area where we can be more effective.

In many instances, however, when franchisees make complaints to the ACCC they are withdrawn soon afterwards or no further information is provided. That makes it very difficult for us to assess the conduct being complained about.

Clearly, franchisees fear retaliation by their franchisor, or perhaps other flow-on consequences. Parliament has taken an important step to address this problem by introducing the new audit powers under the Act.

The new audit powers, which Michael Schaper discussed at length yesterday, came into effect on 1 January this year. They give the ACCC the ability to call for a range of documents from the franchisor to assess whether they are complying with the code.

It means franchisees can advise us of issues anonymously and we can use these powers to audit the franchisor.

The ACCC will use these new audit powers both proactively and reactively to monitor franchising systems.

At the moment our approach to using the audit powers is to select franchisors based on either a history of complaints against them directly, or a disproportionate number of complaints in the industry in which they operate.

We may, however, conduct purely random audits in the future. Thus far the ACCC has issued audit notices to 13 traders covered by mandatory codes of conducts.

I do understand that there is some nervousness on the part of franchisors about being served with one of these notices. Let me to explain a few things about them that may allay your concerns.

If you are served with an audit notice you have 21 days to comply. You may apply for an extension and we are likely to grant it if there are good reasons for you not being able to comply within the timeframe.

Most important, the fact that you have been issued with a notice doesn't mean we have already assessed you as having breached a provision of the code. It may just mean a complaint has been made against you or that we are taking a close look at the industry you're in.

The purpose of the audit is to call for your documents so we can assess if all is in order.

And finally, we can't possibly know the scope of every business we audit and how many documents they hold within each category when assessing compliance with the code.

If the notice inadvertently captures a large volume of documents, we invite you to contact us to explain your situation. Depending on the circumstances, we may decide to narrow our request for documents or give you more time to compile and produce the documents.

These new audit powers give us a window into the businesses that did not exist before. It will give us the capacity to do more with less.

The very exercise of conducting these rolling audits will mean that as a matter of course that, where there has been non-compliance with the code, we will pick it up and act on it.

This is why we will be doing more than before; to ensure a more compliant franchising sector, for the overall benefit of the sector.

Earlier and more frequent intervention by us will improve the processes and protections within a franchising system, as the code intended.

Conclusion

If I can leave you with one message it is that effective regulation can bring significant benefits.

If all franchisors are aware of their rights and obligations under the competition and consumer laws and their own code of conduct, and do the right thing by their franchisees and the community, your sector will thrive as a result.

Thank you for your time today.