Administering the Franchising Code of Conduct

ACCC Chairman, Professor Allan Fels
Hotel Sofitel, Melbourne
1 September 1998

Thank you for the opportunity for me to speak to you today.

The Franchising Code of Conduct, which came into operation on 1 July 1998, is unique in that it is the first mandatory industry code which applies nationwide. The fact that it was introduced pursuant to a provision of the Trade Practices Act means that the ACCC has a role in making sure that the Code is complied with.

I think that it is important to look at the introduction of the Code in a broader context. This Code was part of a package introduced by the Commonwealth Government in April to protect small businesses from unreasonable behaviour of large parties with whom they have commercial relationships. This followed the publication of the Reed Report on Fair Trading which in turn was the culmination of a campaign by small business interests over a number of years. To ignore these new initiatives or to down-play them is to totally misread the current signals from the Australian Government and other parties. The clear signal, simply, is that governments and the community believe that small businesses are given what we in Australia call "a fair go". This doesn't exclude hard bargaining negotiations, etc., but it does target exploitative behaviour.

This Code was introduced to address serious market failure problems, particularly in terms of information failure and the transaction costs associated with franchisees gaining information or obtaining affordable redress when things went wrong in the course of the franchise agreement. There have been some well-known cases where franchisees have lost their shirts as a result of the acts of unscrupulous franchisors. Apart from being a disaster for the franchisees in question, it reflects poorly on the franchising sector as a good place in which to invest.

The previous voluntary system was perceived as inadequate to address these market failures because, as the Gardini Report showed, there was less than total coverage of the franchising sector. The very people who needed to be covered were the ones who did not participate. There was also a perception that when "push came to shove" the voluntary scheme lacked teeth.

What I intend to address today is how the ACCC intends to administer the Code.

I believe that the ACCC should be perceived in its administration of the Franchising Code as a "Compliance" authority. Enforcement of the Franchising Code is just one means of gaining compliance with the Act.

What the ACCC prefers to see is franchisors adopting a best practice approach to ensure that they have systems in place to comply with the Code.

You may be aware that a detailed Compliance Manual has been published to give franchisors assistance to comply with the Code. The Commission has made substantial input into the preparation of the Manual which is available from Commission offices in each State and Territory. In fact, I believe that copies of the Manual are available for sale at this Conference. I would recommend that you purchase a copy and be diligent in setting in place the necessary compliance systems.

One thing that the Commission will be looking at, when it receives a complaint by a franchisee, will be whether the franchisor has been diligent in setting such systems in place. Where there is evidence that the franchisor has been less than diligent, then the Commission will be more of a mind to take firm enforcement action.

The main provisions of the Code will come into operation on 1 October 1998. Given that the Code has been available to franchisors in the marketplace since 1 July 1998, and that the Compliance Manual is now available, I would expect that franchisors should either have systems fully operational by 1 October 1998 or, at the very least, be quite advanced in this process.

It is of critical importance that you have your disclosure document ready by 1 October 1998. There is a very useful pro-forma disclosure document in the Compliance Manual of which you may wish to avail yourself.

Information about territory and supply conditions is of major concern

Based on the United States and Australian complaints data, the areas of major concern in disclosure would be information about the franchise territory and conditions of supply. It is important that this information should be quite clear and that the franchisee is under no misconceptions about the substance of these terms in particular.

You may think that by throwing some information together, you are meeting the requirements of the Code. However, you also need to think of other important legislation which underpins this code. I am thinking particularly of the new provision covering unconscionable conduct in commercial transactions and the provision which proscribes misleading and deceptive conduct.

What this means is that, although you may feel that you have fulfilled the disclosure requirements, you still need to check that the information you provide is not misleading and that the terms and conditions which you have disclosed will not result in unconscionable conduct. The new unconscionable conduct provision, Section 51AC, came into operation on 1 July 1998. The Commission will be publishing a compliance guide in relation to Section 51AC which should be available from ACCC State and Territory offices nationwide by mid to late September.

Conditions not reasonably necessary to protect franchisors' interests

One of the matters which a court can now take into account in determining unconscionable conduct in a franchising transaction is whether the franchisee, as a result of the franchisor's conduct, is required to comply with conditions which are not reasonably necessary to protect the legal or commercial interests of the franchisor.

One example of such a condition might involve penalty provisions which impose obligations upon a party which are disproportionate to the loss or damage caused by the breach.

Another example, which involved the Commission in the past, related to the use of a computer system in the franchise, where the franchisor required franchisees to use software which could only be accessed if a specific password held by the franchisor was used. As a condition of gaining the password, franchisees were required to enter into a franchise agreement of less favourable terms. Under the new unconscionable conduct provisions, it may be argued, in the event of a dispute in which a franchisee is locked out of the system, that such a restriction is not reasonably necessary to protect the franchisor's legitimate interests.

Whether franchisee is able to understand documents

Another matter which the courts can take into consideration as to whether conduct is unconscionable is whether the franchisee has been able to understand the documents used. A related issue is whether the franchisor's conduct was misleading or deceptive. The compliance signal from these matters is that your disclosure documentation should not be only understandable (which might require the use of plain language expertise) but that what you say is correct and capable of being substantiated.

Another related issue in determining whether conduct is unconscionable is whether franchisees were advised to seek independent advice when they have not understood the document. There may be a number of circumstances where the franchisee is unable to understand a franchise agreement. For example, a franchisee might have difficulty with the language, or be inexperienced and lacking in business acumen. Franchisors would be wise to advise such a franchisee to seek independent advice on the operation of the agreement before entering into it.

A further issue which the courts can now take into consideration is whether the amount paid for goods or services supplied is higher, or the circumstances in which they are acquired more onerous, than generally applies elsewhere. While the ACCC acknowledges that some traders are able to negotiate better deals than others and there may be valid commercial reasons for the differences in price and terms, it also recognises that some franchisors may impose terms for which there are no valid commercial reasons.

One example of which the Commission was aware occurred when a franchisor required its franchisees to accept all goods supplied by the franchisor unless the franchisee returned them within 48 hours. While this might appear on the face of it to be a sound commercial arrangement, it may be considered relevant in a claim of unconscionable conduct if the goods arrive on a Friday afternoon, rendering the franchisee unable to return the goods within the agreed time and hence liable to pay for the goods, regardless of whether the franchisee is overstocked or the goods are inappropriate for that store, ie. heavy overcoats for a Townsville franchise. If you think this example is far-fetched, then think again. This was an actual condition imposed in a franchise agreement.

Dispute resolution

One of the important Code compliance issues, as I see it, is the need for franchisors to have set in place by 1 October 1998 the dispute resolution process set out in Part 4 of the Code. If we become aware of a franchisor who has not been diligent in meeting this requirement, then a serious enforcement response from the Commission can be expected.

I think that best practices in dispute resolution should involve having a conflict management system set in place. The Commission, together with representatives from small and large business interests and alternative dispute resolution specialists who have operated in the large/small business disputes area, produced a guide which set down benchmarks for dispute avoidance and resolution of these types of disputes.

Copies of this free publication are available in all Commission offices and I strongly recommend that you obtain a copy. I would further recommend that in particular you adopt the suggested benchmarks of the round table covering conflict management at the company level. These agreed benchmarks for conflict management at a company level include:

- appointment of an in-house disputes manager at a senior level;
- staff training in communication skills, identification of areas likely to generate conflict, and the significance of the agreements involving smaller parties;
- empowering field staff to resolve problems while continuing to permit, if necessary, access to more senior management;
- identification of areas likely to generate conflict;
- policy and procedures for conflict avoidance;
- creating a climate which encourages the raising of problems sooner rather than later;
- development and implementation of a communications strategy; and
- using mentors/business advisers to give advice.

The Commission will take cognisance of franchisors who have implemented these benchmarks.

There are also dispute avoidance benchmarks discussed in this document which again I recommend you adopt as good business practice.

When the Commission receives complaints from a franchisee which essentially comprises a dispute between two parties, we advise the franchisee to use the dispute resolution processes under the Code. However, there may be circumstances where the Commission might choose to take enforcement action. These include:

- where there is evidence that the franchisor has not been diligent in putting in place ***effective*** compliance systems; and
- where there is evidence of systemic non-compliance with the Code and relevant provisions of the Trade Practices Act (eg. Section 51AC, Section 52).

Franchisees will of course have the right to take private action to seek redress when a franchisor breaches its obligations under the Code.

Remedies

A breach of the Code is a breach of Section 51AD of the Trade Practices Act. The remedies available under the Trade Practices Act include:

- injunctions;
- damages;
- requirements for undertakings;
- corrective advertising; and
- other orders.

The Commission has been allocated funds to test new areas of the law; particularly in relation to Section 51AC and the Code. While we are keen to test the new laws, we recognise that parties will often wish to settle the case before a judgement is made. This is in some degree a sign of the success of the law, albeit not a public demonstration of it.

We are, of course, looking for winnable cases. The challenge for the industry is not to give us the opportunity by ensuring that they have set in place effective compliance systems. The message for non-compliant franchisors is that we are more than happy to take up the challenge and establish a test case.

Summing up

The message I want to leave you today is fairly basic. If you are diligent about setting in place effective compliance systems for the Code and relevant sections of the Trade Practices Act (eg. misleading and/or unconscionable conduct, illegal exclusive dealing practices), then the risk of attracting the attention of the ACCC or, for that matter, being sued by a disaffected franchisee is greatly diminished. Equally the converse is true.

Thank you very much.