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Competition and Consumer Policy Division  
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## **An Australian Consumer Law: Fair markets — Confident consumers**

### **Submission concerning 'business consumers'**

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**17 March 2009**

My submission will be limited to the consumer known as the 'business consumer' whose supplier:

- Goes into administration or becomes insolvent (fails), or
- Behaves unconscionably

The business consumer is not defined in the *Trade Practices Act 1974* (Cth) (TPA). Nor was the business consumer accorded any specific attention in the Productivity Commission's 2008 Review of Australia's Consumer Policy Framework.

Franchising is a good business model. ‘... increasing numbers of former employees are becoming franchisees. Franchising also provides an opportunity for immediate gainful work and standing in the community for immigrants who may be unable to convert their original qualifications or be insufficiently strong in English to pursue their original work on arrival in their new country.’<sup>1</sup>

In enacting s 51AC in 1998, the government recognised that business consumers in general, and retail tenants and franchisees in particular, sometimes fell prey to inappropriate behaviour by landlords or franchisors, the more powerful contracting party in the relational contract. While the not breaching the contractual terms of the lease or franchise agreement, and not breaching the Part V provisions of the TPA, the more powerful party nevertheless, may behave in such a way towards the tenant or franchisee that the latter is deprived of the benefit of the lease or franchise agreement as originally envisaged.

I will focus on franchisees as business consumers, as retail leases have been the subject of a separate Productivity Commission inquiry<sup>2</sup> and I believe franchisees are a more vulnerable group of business consumers than are lessees. Franchisees operating from retail premises are parties to contract based relationships with 2 stronger parties – the landlord and the franchisor.

A franchisee who buys a business format franchise signs a standard form relational contract, the Franchise Agreement. In exchange for payment of an up front licence fee, that could be equated to key money in a leasing situation, the franchisee buys a business that should succeed. The franchisee then establishes its franchisee-owned business and works hard to make money. Some franchisors are diligent, professional, supportive of their franchisees and have great systems and a high level of integrity; others fail on all counts.

Some franchisors’ businesses fail<sup>3</sup>. Examples of franchisors failing during 2008 are Kleins, Midas, EzyDVD and Beach House Group. Since 1998 at least 48 franchisors have failed. Their failure has affected their nearly 4,000 franchisees<sup>4</sup>.

The intending franchisee is a highly vulnerable ‘business consumer’ for several reasons:

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<sup>1</sup> Buchan, Jenny. Consumer Protection Policy for Franchisees of Failed Franchisors (November 20, 2008). 2008 Franchise Law Colloquium, Bond University and UNSW, Gold Coast, Queensland, Australia. Available at SSRN: <http://ssrn.com/abstract=1333811>

<sup>2</sup> The Market for Retail Tenancy Leases in Australia Productivity Commission Inquiry Report No. 43, 31 March 2008

<sup>3</sup> CPA Australia, When the Franchisor Fails. [https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-D73369C5/cpa/hs.xsl/726\\_17547\\_ENA\\_HTML.htm](https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-D73369C5/cpa/hs.xsl/726_17547_ENA_HTML.htm)

<sup>4</sup> Perfect date will only be available if franchise disclosure documents are required to be placed on a public database – they can then be analysed. Currently there is no source of objective complete data on the legal aspects of franchise networks in Australia.

1. Information about the structure of the franchisor's business and the risks the actual franchisor has exposure to, and the actual franchisee will be required to assume and be exposed to, is deficient.<sup>5</sup>
2. Franchisees are seldom able to negotiate rights into the franchise agreement<sup>6</sup> that would provide them with options in the event of franchisor failure<sup>7</sup>.
3. When the administrator is appointed to the franchisor, the franchisee enters a limbo phase where they are the stakeholder that arguably has the most to lose and the least ability to do anything about it. (see Problem 1)
4. When a liquidator is appointed to the franchisor's business the franchise agreement and any collateral agreements involving the franchisor such as premises lease or equipment leasing agreements, become assets or liabilities of the franchisor. The franchisee is not automatically a creditor. (see Problem 1)

In the interests of keeping this submission short, I will now list 3 key problems and 3 potential solutions within the scope of this inquiry that I suggest would help address the problems faced by franchisee business consumers whose franchisor fails or who are the victim of unconscionable conduct by a party they are in a long term relational contract with.

### Problem 1

When a franchisor fails (administrator or liquidator appointed) its franchisees have no legal right to respond – just have to sit tight, continue complying with franchise agreement and hope.

- The appointment of administrator/liquidator triggers a stay on litigation, subject to court's right to override stay.
- The franchise agreement is an asset or a liability in the eyes of administrator/liquidator.
- The liquidator has the right under the *Corporations Act 2001* (Cth) to disclaim onerous contracts (franchise agreements, head leases)
- Remedies currently available under Part IV of the TPA presume (in this case erroneously) that

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<sup>5</sup> Buchan, Jenny. Ex ante information and ex post reality for franchisees: The case of franchisor failure. (2008) ABLR 407 - 431

<sup>6</sup> Buchan, Jenny. Can Franchise Agreements Provide for Relief Against Franchisor Failure in the Context of the Common Law? 23rd Annual International Society of Franchising Conference, San Diego, February 2009.

<sup>7</sup> Buchan, Jenny. Can Franchise Agreements Provide for Relief Against Franchisor Failure in the Context of the Common Law? 23rd Annual International Society of Franchising Conference, San Diego, February 2009

the supplier is still solvent. Potentially incentivizes unscrupulous parties to embark on strategic insolvency to avoid franchisee or ACCC initiated litigation.

#### Need a solution that:

- Does not leave the response to franchisor's discretion.
- Acknowledges that franchisor might not fail – it might be the parent company (Ansett/ Traveland) or another critical entity in franchisor's network that fails, taking the franchisor and franchisees with it.
- Gives the administrator a chance to sell/ revive the whole franchise network intact.
- Provides contract-based rights to franchisees.
- Cannot be contracted out of.
- Is not trumped by the rights of administrators and liquidators under the Corporations Act

#### Solution 1

Amend Part V Div 2 and 2A to include **implied terms** in agreements re 'business consumers' that:

The business that the franchisee is buying is of merchantable quality and is fit for the purpose

The franchisor and franchisee will comply with all relevant legislation (eg Corporations Act) and all collateral contract obligations (eg franchisor's obligations under head lease, supplier contracts). (this mirrors provisions in franchise agreements requiring the same of franchisees and would mean could remove current franchisee provision from franchise agreements)

If an administrator is appointed to the franchisor or to any of the entities in the franchisor's network that threaten the franchisee's business (eg Ansett as parent of Traveland franchisor) a 2 step process will be triggered:

STEP1: when administrator is appointed, franchisees can give notice to the administrator that if a satisfactory resolution (restructuring or sale to appropriate buyer) is not found within x days, franchisee will have the right to terminate the franchise agreement, without this being a deemed breach by the franchisee and without it compromising any other rights the franchisee may pursue.

STEP 2: if the administrator does not meet the requirements in x days, the franchisee should be able to terminate the franchise agreement and express its losses as an unsecured creditor in the franchisor's administration/ subsequent insolvency.

#### Issue 2

'Business consumer' not defined in s 2A TPA. Part V 2 and 2A does not cover business consumers.

Statutory threshold is currently too low and too narrow for many business consumers to fall within definition in s 2A.

### **Solution 2**

Provide definition of 'business consumer' in s 2A

Specifically include franchisees in the definition.

Expressly extend Part V Div 2 and 2A TPA to include business consumers

### **Issue 3**

Virtually impossible for individual franchisee to prove franchisor behaving unconscionably under s 51AC.

### **Solution 3**

Redraft events 51AC (a) – (k) as threshold events so s 51AC operates like 51A and 52, and 45A and 45.

If a franchisee establishes that any of events occur as a result of the franchisor's decision or action, the franchisor (being the party that has all the evidence and who has initiated the allegedly unconscionable conduct) has to satisfy court there is no unconscionable conduct.

Thank you for the opportunity to make this submission. I can be contacted by email if there is any aspect of my submission that the Committee wishes to discuss.

Jenny Buchan