



Law Council
OF AUSTRALIA

Business Law Section

22 February 2013

Franchising Code Review Secretariat
Business Conditions Branch
Department of Industry, Innovation, Science,
Research and Tertiary Education
GPO Box 9839
CANBERRA ACT 2601

By email: franchisingcodereview@innovation.gov.au

Dear Sir

**REVIEW OF THE FRANCHISING CODE OF CONDUCT
SUBMISSION BY THE SME BUSINESS LAW COMMITTEE**

This submission concerning the review of the Franchising Code of Conduct is made by the SME Business Law Committee (Small Business) of the Business Law Section of the Law Council of Australia (the Committee).

The Committee is made up of experienced senior legal practitioners working in the commercial and small business area. The Committee discusses, reviews and, from time-to-time, makes recommendations and submissions to government and to policy makers regarding federal and state government policies, laws or regulations that are likely to have an impact on small to medium sized enterprises (SMEs).

Overview

The Committee refers to the following:

- the Discussion Paper – Review of the Franchising Code of Conduct dated January 2013;
- the Submission by the Competition and Consumer Committee of the Business Law Section of the Law Council of Australia (the CCC Submission); and
- a personal submission made by Derek Sutherland (the Sutherland Submission).

Any discussion or proposed law reform regarding the Franchising Code of Conduct will have an impact on SMEs from both the franchisor and franchisee's perspective and,

accordingly, the Committee welcomes the opportunity to make this submission. The Committee has previously made submissions to the South Australian Minister for Small Business in 2011 concerning the Small Business Commissioners Bill 2011 (SA) and, in particular, the impact of that legislation with respect to franchises.

Key Points

The Committee has confined its submission to the following parts of the discussion paper:

- **part 1** – the impact of insolvency or franchise failure;
- **part 3** – good faith in franchising; and
- **part 5** – dispute resolution in franchising.

Submissions

- **Insolvency or Franchise Failure**

The financial failure of a franchisor often results in an insolvency appointment, such as receivership (an appointment by a secured creditor), voluntary administration or liquidation. Presently there is no law that protects a franchisee from an insolvent franchisor, normally through an insolvency practitioner, terminating a franchise without any reasonable or proper notice.

Franchises that are subject to leases where the head lessor is the franchisor, may also be subject to termination without reasonable or proper notice.

The consequences of termination in these circumstances leads to the franchisee's business being lost with little, if any, recourse.

In the case of an insolvent franchisee, an insolvency appointment is likely to trigger an ipso facto clause in a franchise agreement which has the effect of the franchisor without reasonable or any notice, terminating the franchise, "stepping in" to the business of the franchisee and then continuing to operating the franchise and/or re-selling it without having to account to the franchisee for any goodwill or any other value of the franchisee's assets.

The Committee recommends that there be reform to the effect that:

1. In the case of an insolvent franchisor, a franchise cannot be terminated except upon reasonable notice (for instance 30 to 60 days) unless there is an agreement to terminate with the franchisee or, alternatively, an order of the Court if it is demonstrated that the insolvent franchisor, through its insolvency practitioner, is not in a position to trade the franchise or continue to supply services, materials or intellectual property which is the subject of a franchise agreement. A moratorium of, say, 30 to 60 days would enable the franchisee to negotiate a possible purchase of their business, reconfigure their business or, alternatively, participate in a financial work out of the franchisor such as a Deed of Company Arrangement or Scheme of Arrangement.

2. In the case of a franchisee, a similar moratorium period would enable the insolvent franchisee, through the insolvency practitioner, to negotiate a sale of the franchise and realise potential value for the business.

- **Good Faith**

The Committee supports the views set out in the CCC Submission and Sutherland Submission with respect to “good faith”.

The Committee sees no useful purpose in codifying the common law contract doctrine or by trying to limit or expand what the parties may have already agreed. It is becoming more and more common in commercial agreements to include an “acting in good faith” clause.

The Committee is of the view that section 23A could be expanded so that not only is there express acknowledgement that the Code does not limit any obligation imposed by the common law on the parties to a franchise agreement to act in good faith but, also, specifically prohibit the inclusion of a clause in a franchise agreement that is to the contrary. The Committee submits it would be an inappropriate result if the Courts were limited to imply a term of good faith because it would be inconsistent with an express term in the franchise agreement that provides something to the contrary. It is well settled law that that the Court cannot imply a term which is contrary to an express term.

The Committee agrees with the CCC Submission that not only is the requirement of “good faith” something that would be implied into a contract, it is also sufficiently covered with the misleading and deceptive conduct and unconscionable conduct prohibitions in the Competition and Consumer Act 2010 (Cth) (CCA) and the unconscionable conduct provisions in the Australian Consumer Law (ACL).

The Committee too, is concerned that any codification of the definition of “good faith” is likely to lead to inconsistency and a divergence in case law. The Committee agrees with the observations and submissions of the Sutherland Submission.

- **Dispute Resolution in Franchising**

The parties should be required to meet and negotiate and, then if the dispute is not settled, there be a compulsory form of mediation with an obligation on both parties to negotiate during the course of the mediation in “good faith”. The mediation process should not be used to delay a resolution which will be of financial detriment to either party. The parties should not be precluded from agreeing to mediate privately or being subject to a compulsory mediation imposed by a Court.

As set out in the Sutherland Submission, the Committee agrees that there needs to be a protocol in place in dealing with franchise disputes that have for any reason come within the jurisdiction of a Small Business Commissioner.

Further Contact

The Committee would be pleased to address further any of the matter that are raised in this submission. If you have any questions, in the first instance, please contact the

Yours faithfully,

A handwritten signature in cursive script, appearing to read "F. O'Loughlin", enclosed within a rectangular box.

Frank O'Loughlin
Section Chairman