A Co-Regulatory Alternative to a Licensing Regime for Franchising

Executive summary

Franchising is a $135bn sector, with over 2,000 franchise systems employing over 500,000. The *Franchise Council of Australia* (FCA) is the peak industry body, representing franchisors and franchisees.

The Australian Government is considering a franchise licensing regime to better protect franchisees. While the mandatory *Franchising Code of Conduct* (the Code) has been in place since 1998, the ACCC has concluded that the Code on its own cannot adequately protect franchisees.

In 2023, the ACCC therefore recommended either:

- a licensing regime to replace the Code; or
- a strengthened *Franchise Disclosure Register* (the Register) with similar functions as a licensing regime.

While Treasury consultation to date has focussed on the first option, the FCA has developed a proposal for a co-regulatory model based on the second option. This model can achieve the benefits of a licensing regime at much lower cost to government and industry.

Under the FCA's model, a new industry-operated body, provisionally called the *Franchising Accreditation and Mediation Organisation* (FAMO), would manage the Register and oversee accreditation and mediation functions. Each franchisor on the Register would be accredited with a star rating reflective of their compliance.

The star system for franchisors on the Register would function effectively as a licence, and to achieve the highest ratings of four and five stars, a franchisor would need to agree to binding arbitration. The Register, in conjunction with a star rating system, would meet the requirements the ACCC set in 2023 for a model based on a strengthened Register.

An advantage of this approach over licensing is that under the *Australian Constitution* binding arbitration must be entered into voluntarily to resolve disputes; it cannot be imposed by a mandatory Code of Conduct, by the Government or the Parliament. It is not clear to the FCA how licensing could achieve binding arbitration given these constitutional limits.

The model proposed by the FCA has the benefit of allowing potential franchisees to compare the star rating of different franchise systems before entering into a franchise agreement. This would apply some competitive pressure on franchisors to improve their star ratings.

Crucially, the co-regulatory model would reduce the cost to government, with no ongoing funding requirement beyond an initial setup contribution of $5 million. FAMO, as an industry-led organisation, would help ensure regulation remained targeted at actual harm, avoiding the risk of excessive regulation that could dampen business dynamism. The flexibility of the star rating system also means there would be lower transition costs

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for industry: existing franchisors would be grandfathered into the new system with an automatic three star rating, but a four star rating or above would be required before they could take on new franchisees.

Under the FCA's proposal, this model would build on rather than replace the existing Code: the ACCC would continue to have responsibility for investigating and prosecuting breaches of the Code.

FAMO's Board would include representatives from relevant government agencies, such as the ACCC and Treasury. FAMO would be independently reviewed after three years of operation to ensure it was meeting its objectives.

This co-regulatory approach has a highly relevant precedent: the *Australian Travel Accreditation Scheme* (ATAS), an industry-led scheme, which has successfully been providing accreditation to travel agents for 12 years. The scheme has been independently reviewed twice to ensure it remains fit for purpose, with a third independent review underway.

Background

In late 2023, Dr Michael Schaper completed an independent review of the Franchising Code of Conduct (the Code), a mandatory code under the *Competition and Consumer Act 2010*.

In its submission to the Schaper Review, the ACCC said:

> *"After over 25 years of a mandatory industry code of conduct, the ACCC considers that even an amended Code cannot prevent or address the persistent harms that arise in franchising*." (p. 2)

According to the ACCC, the limitation of the Code was that it was an *ex post* regulatory model:

> "*Ex post enforcement alone cannot rapidly prevent or limit harm to prospective or current franchisees when there is a problem. The ACCC can only take action where the harm has occurred."* (p. 2)

The ACCC acknowledged its capacity to deal with every complaint was limited, highlighting that it *"... is not a complaints resolution agency and rarely becomes involved in individual disputes".* It added that *" ... the majority of franchise matters received by the ACCC each year do not meet the ACCC's priority factors"* (p. 8).

Consequently, the ACCC urged that a preventative approach to harm needed to be taken via an *ex ante* regulatory model: obligations would be imposed on franchisors before they could operate as franchisors. If a franchisor breached its obligations, the regulator could suspend or cancel its ability to operate.

The ACCC's requirements for such a model were:

- clear conditions on franchisors from the start;
- and throughout the franchise, including when seeking new franchisees;
- stronger regulatory tools to address localised and future harms to franchisees; and
- accessible, binding dispute resolution.

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The ACCC saw licensing as the most obvious way to achieve these requirements, but acknowledged the risk of regulation that was overly interventionist. It put forward a strengthened Register as being an alternative option. The ACCC suggested that a strengthened Register could achieve some of the benefits of licensing, provided:

- to be listed, a franchisor had to comply with certain requirements and agree to abide by accessible binding dispute resolution decisions; and
- the appropriate regulator could suspend, cancel or impose conditions on a franchisor to remain listed in the manner discussed above (p. 10).

The ACCC encouraged the Schaper Review to *" … seriously consider the benefits of replacing the Code with a licence regime or strengthening the existing Franchise Disclosure Register framework." (p. 10)*

The Schaper Review, in turn, recommended that the Australian Government should investigate the feasibility of a licensing regime, and said *" … consideration should also be given to leveraging the [Register] infrastructure and obligations to support any move from registration to formal licensing."*

In its response, the Australian Government accepted the Schaper Review's recommendation and established a Treasury Taskforce to conduct a cost–benefit analysis of introducing a licensing regime for franchising. As required by the Office of Impact Analysis, normally at least three options would be considered in such analysis.

In November 2024, the Treasury Taskforce said in its consultation paper:

> "A licensing regime would seek to promote positive commercial relationships, fair trade and access to justice, and competition within the sector. *However, it is also important to consider the possible limitations of a licensing regime, including increased regulatory oversight and the operational constraints that may apply to the sector, as well as its transitional and ongoing costs."* (p. 4; emphasis added)

While the Consultation Paper addressed the Register, it did this only in the context of its current function, rather than as a potential way to achieve the benefits of licensing at a lower cost in the way that the ACCC and the Schaper Review had suggested.

The Treasury Taskforce is currently exploring a government licensing regime for franchising and has recognised its advantages, while also noting its limitations, including increased regulation and transitional and ongoing costs for both industry and government.

The question therefore arises: is there a better way?

A proposed co-regulatory entity without the need for licensing

The FCA proposes, instead of a licensing regime, a co-regulatory model combining an amended mandatory Code with an industry-led organisation to oversee a strengthened Register.

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The FCA's model meets the two requirements set out by the ACCC of a strengthened Register, namely access for franchisees to binding dispute resolution and an ability to cancel, suspend or put conditions on a franchisor's accreditation.

The organisation, provisionally titled the *Franchising Accreditation and Mediation Organisation* (FAMO), would be owned and operated by the FCA and its members, though franchisors would not need to be FCA members to be listed on the Register.

The star system could be designed as follows:

- three stars would allow a franchisor to continue operating its existing franchise agreements;
- four stars would be available only to franchisors who had voluntarily agreed to binding arbitration and this would allow a franchisor to take on new franchising agreements; and
- five stars would be available only to franchisors who had voluntarily agreed to binding arbitration, who provided audited accounts and who met solvency tests.

Under this model, existing franchisors would be grandfathered and automatically granted a three star rating, meaning they would not be disrupted in their existing franchise agreements. Achieving the conditions of four (and five) stars would be required for the franchisors to take on new franchisees.

The FCA would welcome the opportunity to work with the ACCC and Treasury on what additional conditions would apply under the different star ratings.

The Code would continue to operate in parallel and be administered by the ACCC. An amendment to the Code could set out the minimum requirements on a franchisor to operate. Under extreme circumstances, such as persistent breaches of the Code, a franchisor's accreditation and listing on the Register could be cancelled (if this were constitutionally possible), in accordance with the amended Code.

FAMO Board structure

The FCA suggests the FAMO Board could include an independent chair, a representative of the ACCC, a representative of Treasury or another government agency, a franchisor representative and a franchisee representative. Such diverse representation would ensure the model would achieve the intended purpose of reducing harm to franchisees. The model could be independently reviewed every three years to ensure it remained fit-for-purpose. The government would of course retain the option of moving to the heavier regulation of a licensing regime if co-regulation proved ineffective.

Dispute resolution

The ACCC's submission proposes the inclusion of compulsory arbitration in its licensing regime, whereas the FCA questions whether this is constitutionally permissible.

FAMO would have a *Complaints and Mediation Committee* separate from administration of the Register. This would include binding arbitration for franchisees of four and five star-rated franchisors, incentivising

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franchisors to voluntarily agree to binding arbitration as a means to make their franchise as attractive as possible to prospective franchisees.

Timing and funding

The FCA believes it is feasible to have the co-regulatory model operating from 1 November 2027. It is seeking $5 million in Australian Government funding over two years to establish the Scheme. The model would not require ongoing government funding.

An existing precedent – the Australian Travel Accreditation Scheme (ATAS)

The *Australian Travel Industry Association* (ATIA) represents more than 1,100 members with over 28,000 employees nationwide. Its predecessor, the *Australian Federation of Travel Agents* (AFTA), received unanimous agreement from all levels of government in 2013 to establish an industry-led accreditation scheme. All State and Territory governments then repealed their *Travel Agents Acts*, which had required travel agents to be licensed.

The *Australian Travel Accreditation Scheme* (ATAS), administered by the ATIA, has operated effectively for 12 years and has undergone two independent reviews, with a third currently underway. ATAS operates under a voluntary code, whereas an industry-led franchising accreditation scheme would work with the current mandatory Code. ATAS, as with the proposed co-regulatory model for franchising, does not require ongoing government funding.

Productivity benefits

The FAMO model would reduce barriers to business dynamism, and therefore increase productivity, because it will enhance higher entry rates into franchising. There is evidence of growth in the number of agile *'frontier firms'* in franchising. The industry supports the FAMO proposal and does not support licensing. FAMO, as an industry-led organisation, would help ensure regulation remained targeted at actual harm, avoiding the risk of excessive regulation that could dampen business dynamism (and thus harm productivity).

The flexibility of the star rating system also means there would be lower transition costs for industry: existing franchisors would be grandfathered into the new system with an automatic three star rating, but a four or five star rating would be required before they could take on new franchisees.

The FCA is aware of global franchise systems which are reticent to enter Australia due to the perceived risk of stand-alone licensing regulation. Similarly, there are Australian franchise systems which are preferring to move offshore, due to the perceived risk of licensing regulation.

Budget sustainability

Under FAMO, the industry will administer the Register from, say, 1 November 2027. Treasury and the ACCCC will no longer be responsible for the administration of the Register from that date, and this will ensure budget sustainability, after once-only set up funding of $5m.

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The idea is Budget positive

FAMO will be budget positive over the *Forward Estimates*, with annual savings from FY28. Treasury and the ACCC will no longer need to resource the administration of the Register from 1 November 2027. This will be a significant annual saving to the Budget after the commencement of FAMO. The industry seeks once-only $5m funding to establish the Scheme over 2 years ($2.5m in each of FY27 and FY28).

Next steps

While the ACCC said in its submission to the Schaper Review that a strengthened Register would achieve *some* of the benefits of licensing, the FCA cannot foresee any impediments to this co-regulatory approach achieving *all* of the benefits of licensing. The FCA seeks to engage constructively with Treasury and the ACCC to explore how this co-regulatory model could achieve this outcome, while avoiding the acknowledged risks of licensing.

Timeline considerations

Detailed Submission

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