FIXING THE VOID IN AUSTRALIAN FRANCHISE LAW:

FRANCHISOR OPPORTUNISM AND THE FAILURE TO RENEW FRANCHISE AGREEMENTS

Executive Summary

1. This submission concerns a problem with the efficacy of current laws regulating the franchisee/franchisor relationship in Australia, particularly in relation to the renewal of franchise agreements when their term expires.[1]

2. Competitive Foods Australia Pty Ltd ("CFAL") is both a franchisee and a franchisor in the Australian market, and has built up its business from a single KFC store which it opened in Perth in 1969. As a result of events late last year at Rockingham in Western Australia, CFAL has a unique insight into the problem of the "franchisor opportunism".[2]

3. The situation at Rockingham exposed a void in Australian law where a franchisee is left without any effective legal protection if a franchisor fails to renew, or threatens not to renew, a franchise agreement (and thereby destroy the goodwill built up in the business by the franchisee) to obtain a benefit that it could not otherwise obtain from the franchisee.

4. The Franchising Code under the Trade Practices Act does not deal with non-renewal, even though it places restrictions on a franchisor's power to terminate the franchise agreement during the term of that agreement. Additional disclosure under the Franchising Code of the risk that a franchisor might not renew the franchise agreement, as recommended by the Matthews Committee,[3] would not solve the problem, and would merely entrench a franchisor's right to act opportunistically.

5. Existing contract law and the unconscionability provisions of the Trade Practices Act and Fair Trading Acts are also of no ready assistance, because those remedies would appear to

---

[1] This Submission has been prepared for provision to the West Australian Government's Inquiry into the Operation of Franchise Businesses in Western Australia (the Bothams Inquiry) and the inquiry being conducted by the Economic and Finance Committee of the Parliament of South Australia into Franchises. A copy of this Submission will also be provided to the Productivity Commission in relation to its inquiry in relation to Retail Tenancy Leases.

[2] R.D. Blair & F. Lafontaine, *The Economics of Franchising*, Cambridge University Press, New York, 2004, ch.10; J. Klick et al, 'The Effect of Contract Regulation: The Case of Franchising', http://ssrn.com/abstract=951464, 2006.

[3] Matthews Committee, 'Review of Disclosure Provisions of the Franchising Code of Conduct, October 2006, Recommendation 20.

apply only during the contractual term and not when the contract expires. In the absence of any effective legal for the franchisee, the mediation provisions in the Franchising Code will not address the imbalance of power between franchisor and franchisee in relation to the non-renewal of a franchise agreement.

6. Franchising differs from other types of contracts insofar as the individual business units only exist because of the time, capital and effort invested by the franchisee in building up that business. Unlike a retail lease, for example, the franchisee cannot simply return the premises to their original condition and take its business elsewhere. Thus, the consequence of condoning "franchisor opportunism" is that the franchisor is granted a free option to acquire the franchisee's business at the end of the franchise term on terms of the franchisor's choosing, which is backed up by the threat that it can force the closure of the business if the franchisee does not agree to the franchisor's demands.

7. What is needed in Australia is a level playing field for negotiations to take place fairly between franchisor and franchisee about the renewal of franchise agreements. A key feature of the franchise relationship is that the parties should act in good faith towards each other during the contractual term. CFAL would like to see the same requirement apply to the issue of renewals to overcome the problem of "franchisor opportunism". Such a requirement would not only assist franchisees, but would benefit the franchise industry and the economy generally by allowing franchisees to invest in their businesses, secure in the knowledge that they can recoup that investment over time, rather than facing the threat that their investment might be taken away by an arbitrary decision on the part of the franchisor. Franchisors who act in good faith and fairly towards their franchisees should have no cause for concern from this type of regulation.

8. This submission recommends the adoption of three measures to overcome the problem of "franchisor opportunism" and establish a level playing field for franchise renewals:

    a. Amend the Franchise Code to include a provision requiring a franchisor to renew the franchise agreement on expiry, unless the franchisor had a good faith reason not to do so. Such an amendment could be made by the Federal government based on earlier Commonwealth legislation to deal with problems in the oil industry in relation to petrol station franchises, or alternatively the government can look to “good cause” legislation adopted in a number of the states in the USA.

    b. Clarify the operation of the unconscionability provisions of the Trade Practices Act and State Fair Trading Acts to ensure that these protections apply to renewal of franchise agreements. This change would enable a franchisee to take legal action to stop a

franchisor from misusing its superior bargaining position and require a franchisor to act reasonably and in good faith in negotiating a renewal of a franchise agreement. This could be done in the first instance by amending the Trade Practices Act and the Fair Trading Acts to allow the relevant Minister to make regulations at short notice to respond to particular types of abuse of power by a franchisor (or other contracting party).

c. Consider the introduction of provisions in either the Franchising Code or the Trade Practices Act/Fair Trading Acts to require a franchisor to compensate a franchisee for the value of the franchise business if the franchise is not renewed. Such provisions would remove the economic incentive for franchisors to act opportunistically, and would secure the franchisee's investment in the business (subject to market forces determining the value of that business).

9. Although "franchisor opportunism" has been well recognised in the economic literature for some time, the evidence in Australia and the United States suggests that over 90% of all franchises are renewed when they expire.[4] However, the Rockingham situation provides clear evidence that this will not always be the case, and that a franchisor can inflict a significant loss on a franchisee by refusing to renew the agreement. The mere threat that this sort of loss can occur brings into question how often franchisees are forced into submission to the wishes of a franchisor because of the fear of non-renewal.

10. CFAL urges this Inquiry to grasp the nettle of resolving the problem of franchisor opportunism, which has now been publicly exposed by the Rockingham closure, and make recommendations for substantial reform. The broad public interest in the health and vibrancy of the franchise industry requires a comprehensive response to this problem by all Australian governments, as outlined in this submission.

CFAL and the Rockingham Closure

11. Competitive Foods Australia Pty Ltd ("CFAL") is both a franchisee and a franchisor in the Australian market. CFAL has built up its presence in the Australian market since its founder, Jack Cowin, opened his first KFC restaurant in 1969 with funds borrowed from 30 investors. Despite its current size, CFAL has first hand experience of the problems that all franchisees face when their franchise agreements expire, based on the closure of one of its KFC restaurants at Rockingham, Western Australia in November 2007, after 30 years' successful operation.

---

[4] Blair & Lafontaine, The Economics of Franchising, *op. cit.*, p.263 refer to evidence that 93% of all franchises that expired in the US in 1986 were renewed. In the Griffith University survey by L. Frazer et al, *Franchising Australia 2006*, the data indicated that the rate of non-renewals upon expiry of franchise agreements in Australia in 2003-2005 ranged from 1.5%-3.7%.

12. The main events in the history of the Rockingham restaurant prior to 2007 were:

    a. Restaurant opened on 19 November 1977, with an initial building cost of $156,000;

    b. Restaurant upgraded in 1985 at a cost of $106,000;

    c. Restaurant upgraded in 1998 at a cost of $303,000.

13. The Rockingham closure occurred in a context where Yum had offered to buy CFAL's network of 50 KFC restaurants in WA and the Northern Territory. The price offered by Yum was calculated by reference to the balance of the franchise term for each of the restaurants, which is approximately half the value of the restaurants calculated on the basis of their ongoing value (using a formula calculated as a multiple of each restaurant's earnings). Thus, CFAL was presented with a choice of selling its KFC network at a significant undervalue, or facing the closure of Rockingham.

14. Yum has told CFAL that it intends to follow the same procedure and force the closure of CFAL's other 49 KFC restaurants in WA and the Northern Territory as they expire progressively over the next 20 years. The next three restaurants facing closure are at Whitfords, Beechboro and Thornlie, in December 2008. Although CFAL has told Yum that it is prepared to consider the sale of its KFC network for a proper price (whether to Yum, management or a third party), its preferred position would be to continue to invest in and develop its existing network further in WA.

15. In order to avoid the closure of the Rockingham restaurant, CFAL also offered to enter an interim arrangement with Yum. As part of that arrangement CFAL offered to share some of the Rockingham profits with Yum, whilst the parties entered negotiations about the future of the restaurant. Yum declined that offer, with the consequence that the Rockingham restaurant was closed. CFAL continues to have discussions with Yum and other interested parties with a view to resolving the Rockingham situation, and avoiding any further restaurant closures.

16. CFAL has since lodged a Reform Proposal with the Federal government for amendments to the Franchising Code to require a franchisee to renew a franchise agreement (or provide compensation in lieu) unless the franchisor has a good faith reason not to renew.[5] The proposed regulation would also require franchisors to give reasons for non-renewal, and the franchisee would be able to bring proceedings to enforce its right to renew or obtain compensation in lieu.

[5] Competitive Foods Australia Pty Ltd, 'Reform Proposal: Failure to Renew Franchise Agreements', 21 January 2008. That Reform Proposal elaborates on a number of arguments identified in this submission, and CFAL adopts those additional arguments for the purpose of this submission.

17. Prior to the closure of CFAL's Rockingham restaurant, Yum lodged a development application with the City of Rockingham Council to build its own KFC restaurant in close proximity to the existing CFAL restaurant (which currently remains closed and fenced off). That application was initially rejected by the Council. Yum has since appealed to the State Administrative Tribunal, and also lodged a revised development application with the Council.

The Franchising Industry

18. The franchising industry plays a major role in the Australian economy, in terms of its financial significance and its impact upon the lives of hundreds of thousands of Australians and their families as owners, employees and suppliers.

19. The essence of the franchisor/franchisee relationship is the sharing of risk and revenue to develop a market for a product or service. The typical franchise model involves:

    a. The franchisor provides intellectual property, the system and coordinates/controls the marketing. For this contribution it receives a relatively risk free revenue stream.

    b. The franchisee provides energy and capital – human and financial - to develop the business. For this contribution they have an opportunity to earn significant profits from their business.

20. Key features of the franchise relationship are:

    a. The franchise starts with a contract. It is typically a standard form, take-it or leave-it contract.

    b. There will usually be a fixed franchise term, which may be for a long term of 10 years or more.

    c. The franchisor will have the right to require the franchisee to maintain particular standards which are linked to:

        i. The image of the brand;

        ii. The maximisation of the franchisor's revenue stream.

    d. The franchisor does not guarantee that the franchisee will be successful in the franchise business.

21. Additional features typically found in franchising, in CFAL's experience, are:

a. Franchisors have extensive contractual powers to terminate the franchise contract, particularly for a failure to comply with standards instituted by the franchisor.

b. Franchisors have a right to acquire equipment at written down cost at the end of the franchise agreement.

c. Franchisees have no right to recover any goodwill established in the business at the end of the franchise term.

d. Franchisees will be subject to restraint of trade provisions limiting the franchisee's options for taking up new business opportunities (related to the type of business previously operated by the franchisee) both during and at the end of the franchise term.

22. In relation to restaurant franchises, a key issue that arises between the franchisor and franchisee is the question of restaurant upgrades. There are several considerations involved with this issue:

a. The presentation of a restaurant at any time is part of the overall brand presentation in the market. Customers expect that the experience at one restaurant will be the same as that of another restaurant trading under the same brand.

b. The franchisor has a contractual right and duty to coordinate the brand image amongst all franchisees.

c. The franchisee is responsible for the cost of renovating or upgrading restaurants to meet the then current store image determined by the franchisee.

d. The accepted wisdom in the industry is that a new or renovated store will perform better than a tired, old store.

e. There is therefore an important point of tension which arises between franchisors and franchisees over the timing and cost of store upgrades:

i. Franchisors would prefer to have more upgrades, more often and often involving new themes to build system revenue.

ii. However, the capital cost of upgrades and disruption associated with upgrade works means that franchisees would prefer to have fewer upgrades, less often and involving fewer changes.

f. A further important consideration relating to investment by a franchisee in an upgrade is the length of time over which the franchisee can recoup his or her investment – this is

particularly relevant if the franchisee has no right of renewal and no ability to receive a goodwill payment on termination of the franchise.

23. The restaurant upgrade issue therefore focuses attention upon a key point of tension in the franchise relationship:

    a. When the parties enter a franchise agreement, which may be a long term agreement, they do not know what expenditures may be required over the contract term to meet the evolving demands of the market – whether in terms of capital upgrades or otherwise;

    b. However the contract will provide that the franchisor has the power to control the brand image and to impose requirements upon franchisees during the contractual term, even though the nature and cost of these requirements cannot be predicted in advance;

    c. The problem therefore is how to ensure that the franchisor acts in a way which maximises the return for franchisees referrable to the costs incurred. An important factor in this calculation is the period over which the franchisee can recoup that investment.

24. In CFAL's experience the cost of restaurant upgrades and remodelling is substantial and often exceeds the initial establishment costs of the franchise restaurant over the term of the franchise agreement. The figures quoted earlier in relation to Rockingham are consistent with this experience.

25. It is now well accepted in Australia that the tensions that exist in franchise relationships require some measure of external intervention and accountability, through government regulation and the courts. This system of regulation and its shortcomings are addressed in the following section.

Franchise Regulation in Australia

26. The legal structure regulating franchising in Australia involves the following key elements:

    a. A national Franchising Code established by regulation under the Trade Practices Act.

    b. Provisions of general application under the Trade Practices Act and state Fair Trading Acts – in particular prohibitions against:

        i. Misleading and deceptive conduct;

        ii. Unconscionable conduct.

c. The general law of contract, including the doctrines that contracting parties must act reasonably and in good faith in exercising powers under the contract.

27. The Franchising Code is heavily based on the principle of disclosure. This places the onus on a prospective franchisee to carefully investigate and consider whether or not it should enter into a particular franchise agreement.

28. However the principle of disclosure is inherently limited to such matters as can be disclosed in advance, and in reality there are several fundamental issues that are unknown at the time a franchise contract is entered into, including:

a. What changes will occur to the franchise system over the term of the franchise agreement.

b. What requirements will exist for capital investment to maintain the current image of the franchise system at unspecified times in the future.

c. What action will be taken by the franchisor in the future to deal with franchisees who cannot or do not comply with changes directed by the franchisor to meet the current system image.

29. Whilst a franchisor can protect itself by building in protections in its standard form franchise agreements, the problem is how the rights and expectations of the franchisee can be protected. Some of these problems are addressed by mandatory provisions in the Franchise Code, specifically clauses 20-22 which place restrictions on the rights of the franchisor to terminate the franchise agreement prior to the expiry of its term.

30. Otherwise, a franchisee's only protection arises under the general law of contract as supplemented by the Trade Practices and Fair Trading Acts.

31. First, there is the doctrine of good faith as a matter of contract law. This is a developing area of law, which is not universally accepted by the Courts.[6] The issues that can arise in relation to this doctrine are:

a. Some courts appear to be wary of a notion of "good faith", possibly because it lacks the certainty normally associated with the interpretation of contracts. The answer to this

[6] Good faith has been applied in contracts relating to franchising in *Burger King Corporation v Hungry Jacks Pty Ltd* [2001] NSWCA 187; *Far Horizons Pty Ltd v McDonalds Australia* [2000] VSC 310, *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286 and see also *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd* (2006) VSC 223. See also Attachment F to the Matthews Report, 'Good Faith and Fair Dealing'.

problem is that franchise contracts are a special class of relational, organic or incomplete contracts where contractual certainty is very difficult to achieve at the outset of the contractual term.7

The recent Matthews Committee report, in particular, acknowledged the role of good faith in franchise contracts and recommended that:

> "A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part 1 of the [Franchising]Code".[8]

The then Federal Government did not agree to amend the Code as suggested, although it did accept the intention of the Matthews Committee recommendation, as follows:

> "The Government agrees with the intention that franchisors, franchisees and prospective franchisees act towards each other fairly and in good faith. Section 51AC of the Trade Practices Act 1974 includes 'good faith' as a factor that can be taken into account when determining unconscionable conduct."

Given the uncertainty surrounding the application of s.51AC to issues of franchise renewal, (discussed below), the former Federal Government's response highlights the void in the current Australian law relating to renewals. That is, if the intention is that parties deal with each other in good faith at the time of franchise renewals (which the former Government seemed to support), it must either broaden the scope of s.51AC to include franchise renewals, or it must amend the Code to specifically incorporate a requirement of good faith in relation to franchise renewals.

b. "Good faith" depends upon the intentions of the franchisor and not the effect on the franchisee. A practical test of whether a party is acting in "good faith" is whether the franchisor has acted capriciously or for an extraneous purpose. An action may have significant adverse consequences for a franchisee, but may be allowed in some circumstances if the intentions of the franchisor were good (eg. major overhaul of brand image world-wide) and disallowed if the intentions are bad (eg. specific measure

---

[7] For articles which consider the implications of this developing area of law, see A. Terry, 'Franchising , relational contracts and the vibe', *Australian Business Law Review*, vol. 33, 2005, pp.289-300; G.K. Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts', *Stanford Law Review*, vol.42, 1990, pp.927- 992.

[8] Matthews Committee Report, Recommendation 25, 'Implementation of the principle of good faith and fair dealing'.

designed to force a particular franchisee into default). In addition, the onus of proving the lack of good faith rests with the franchisee.

c. As a consequence of the above, resort to a contractual duty of "good faith" involves an inherently unpredictable court process, which reduces the likelihood that this remedy will be used except in extreme cases or by franchisees with the financial capacity to take the risk of funding proceedings through to conclusion.

32. Secondly, there is the remedy of unconscionable conduct under the Trade Practices and Fair Trading Acts.[9] These provisions are relatively new, and the Courts are still developing their interpretation of these provisions. Some of the issues which arise in relation to the use of the unconscionability provisions are:

a. Unconscionability is only partially defined by the legislation, and it is therefore unclear when these provisions would operate:

i. In s.51AA of the TPA, unconscionability is defined by reference to the current unwritten law. This means that s.51AA does not extend beyond traditional equitable doctrines of unconscionability which have only operated in very limited circumstances.

ii. In ss. 51AB and 51AC of the TPA, unconscionability is not defined at all, which has led some commentators to suggest that a wider interpretation of unconscionability is possible under these provisions. Note however that the operation of s.51AB is limited to the supply of goods and services to consumers for personal, domestic or household use, and is therefore not applicable to franchise situations.

b. There are, however, a number of factors that can be taken into account to determine whether conduct is unconscionable, which are set out in s.51AC of the TPA. These primarily relate to the presence of unequal power in a relationship. The implication from these factors is that s.51AC is designed to protect a stronger party from using unequal power to achieve an outcome that would not have occurred if the parties had been acting on a level playing field.

[9] The three substantive provisions in the Trade Practices Act dealing with unconscionability are s.51AA (unconscionable conduct within the meaning of the unwritten law of the States and Territories); s.51AB (unconscionable conduct in relation to consumers); s.51AC (unconscionable conduct in relation to small business transactions). The Fair Trading Act (WA), s.11, adopts ss.51AB and 51AC only. The Fair Trading Act (SA) s.57 adopts s.51AB only.

c. Although the principles of good faith and unconscionability may overlap to some extent, each of them has a different point of focus: good faith is concerned with why a franchisor did something; unconscionability looks at the outcome of the franchisor's actions and the means used by the franchisor to achieve that outcome. However, a lack of good faith by a franchisor may provide evidence of unconscionability, as recognised by s.51AC(3)(k) of the TPA.

33. Thirdly, contractual good faith and statutory unconscionability only operate during the term of the contract and do not relate to contract renewals. As a matter of legal theory, a contract renewal involves a decision whether or not to enter a contract – being a new contract on expiry of the old contract. This classification appears to be artificial when applied to a franchise relationship, particularly one which has subsisted over many years, if not decades. Nevertheless, in the face of a franchisor who seeks to assert its right to rely upon the doctrine of freedom of contract, the legal obstacles confronting a franchisee may be summarised as follows:

a. A contractual duty of good faith will only apply to powers exercised during the term of an existing contract, and will not apply to any renewal decision by the franchisor.

b. Unconscionability under s.51AA does not apply to contract renewals. This appears to be the consequence of the High Court's decision in ACCC v Berbatis (2003) 214 CLR 51, at least in relation to leases and presumably also in relation to franchises. In that case, the High Court held that it was not unconscionable under s.51AA for a landlord to require a tenant to drop legal proceedings against the landlord in return for being granted a renewal of the tenant's lease.

c. Unconscionability under s.51AC is untested in relation to contract renewals. If unconscionability does have a wider operation under s.51AC than s.51AA, there is a potential issue whether the High Court's reasoning in the Berbatis case will also apply to s.51AC. It may take many years of litigation for this issue to be resolved by the courts, as the case is ultimately likely to end up in the High Court.

34. It is useful to compare the position of a franchisee with that of a retail tenant, because there are some similarities but there are also some important differences.[10]

35. The main similarities are that a tenant may be subject to similar opportunistic behaviour by a landlord as franchisees in relation to lease renewals:

[10] At the time of preparing this submission, the Productivity Commission has issued a draft report, *The Market for Retail Tenancy Leases in Australia*, November 2007.

a. The underlying relationship is contractual, and involves a strong party (the franchisor or landlord) and a weaker party (the franchisee or tenant).

b. The terms of the contract are generally presented on a take-it or leave-it basis by the stronger party to the weaker party.

c. The weaker party has no right to any payment of goodwill upon expiry of the contract, and thus is an 'economic captive' to the demands made by a landlord or franchisor in order to obtain a renewal to protect its business investment and to ensure that it can continue to meet its third party property or financing obligations (ie. leasing, rental or mortgage obligations).

36. However the differences are significant, and these indicate the much weaker position of the franchisee compared to the retail tenant:

a. The franchise contract is a relational, organic or incomplete contract, where many issues are left open-ended, such as those relating to changes to the franchise system and capital expenditure on upgrades. By contrast, a retail tenancy involves a complete contract, with all major obligations being spelt out in the lease agreement and well recognised means of determining rental changes.

b. Different investment decisions are made by tenants and franchisees during the course of their contractual term. The tenant's decision will typically be limited to fitout of existing premises where all of the other facilities and services are provided by the landlord. However, the franchisee is typically provided with only a contractual right to use the brand name and other intellectual property rights. Thus, the franchisee's investment must extend to every other aspect of the business, including for example providing the land and buildings.

c. At the end of the contract term, a franchisee does not have any business which he or she can take elsewhere, but must start again, and may be further limited by restraints of trade covenants. A retail tenant does not suffer from these limitations but can find new premises and resume its business activities from these premises without any restraints. The retail tenant's ability to walk away from unreasonable renewal terms, and relocate its business, places a limit upon the extent to which it is an economic captive of the landlord, and thus upon the ability of the landlord to behave opportunistically. There is no similar restraint upon a franchisor.

37. Although the draft Productivity Commission report does not expressly address the issue of opportunistic behaviour by landlords per se, a key insight of that report is the need to draw a distinction between "what constitutes unfair or unconscionable behaviour as opposed to a hard bargain". This is the same issue posed by the High Court in the *Berbatis case*, which effectively upheld the right of the landlord to make a hard bargain on renewal with the tenants (even though that conduct fits the description of opportunistic conduct). The draft Productivity Commission report included a draft finding that recommended against extending the reach of the existing unconscionability provisions, although it did acknowledge the need for greater clarity in the interpretation of those provisions.[11] A crucial step in the reasoning in the draft Productivity Commission report is:

> "...large rent increases on lease renewal do not automatically indicate a lack of negotiating power on the tenants' part... The main bargaining chip available to tenants is the ability to 'vote with their feet'. Therefore, tenants need to be able to evaluate viable rent levels for their business model and ensure that they are in a position to walk away from negotiations if the proposed rental increases are considered too high." [12]

However, applying the reasoning of the draft Productivity Commission report, it is the very inability of franchisees to "vote with their feet" that strengthens the case for reform of the unconscionability provisions in relation to the franchise industry to overcome the problem of franchisor opportunism. Put another way, even if landlord opportunism falls on the hard bargaining side of the line (as the Productivity Commission's draft report appears to accept), franchisor opportunism should fall on the side of the line requiring regulatory intervention. This issue is addressed in more detail in the following section.

38. Finally in relation to retail tenants, South Australia and the Australian Capital Territory have protected preferential rights in relation to renewal of their leases and a right of compensation in circumstances if their leases are not renewed.[13] The draft Productivity Commission report noted a submission that such provisions increased compliance costs for landlords; however, it concluded instead that the effect of the provisions was difficult to assess. [14]

---

[11] Productivity Commission, The Market for Retail Tenancy Leases in Australia, *op. cit.*, pp. xxxii, 86, ch.9.

[12] Productivity Commission Draft Report, *ibid.*, p.106.

[13] The Retail and Commercial Leases Act 1995 (SA), ss. 20C-20I provides an existing tenant with a preferential right to renew the lease unless the landlord has one of a number of specified reasons for not renewing (eg. changing the tenancy mix). The court has powers to intervene in a dispute, which include making an order for a new lease or payment of compensation up to the amount of 6 months' rent. Similar provisions are contained in the Leases (Commercial and Retail) Act 2001 (SA), ss.106-112.

[14] Productivity Commission Draft Report, *op. cit.*, p.107.

Regulatory Reform: Introduction

39. At the level of economic principle, the fundamental approach of Australian governments in recent times is that the market should be the primary means of determining economic efficiency and allocating resources. There should be incentives for businesses to succeed; and on the other hand there is a recognition that some businesses will inevitably fail.

40. However markets do not always operate efficiently, particularly where an inequality of bargaining power or knowledge exists between participants to a potential transaction. Thus, there is a necessary role for some regulation to support and supplement market mechanisms. The Trade Practices Act, Fair Trading Acts and Retail Tenancy legislation are all founded on this basis.

41. The Productivity Commission Draft Report in relation to Retail Leasing noted the "*six key principles*" for developing regulatory reforms based on the work of the 2006 Regulatory Taskforce. The first three of these principles, which are relevant to the introduction of regulatory reform, are addressed in this Submission. These are:

- Governments should not act to address 'problems' until a case for action has been clearly established.

  -This should include establishing the nature of the problem, and why actions additional to existing measures are needed, recognising that not all 'problems' will justify (additional) government action.

- A range of feasible options – including self-regulatory and co-regulatory approaches – need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.

- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.[15]

Principle 1: The Problem of Franchisor Opportunism

42. The problem of non-renewal forms part of a well recognised doctrine known in the economic literature as "franchisor opportunism".[16] This doctrine recognises:

    a. Franchisors have an incentive to assist franchisees to explore and build a market for the franchisor's product. If successful the franchisor earns relatively risk free revenue, based

[15] Productivity Commission Draft Report, *op. cit.*, p.83.
[16] See footnote 2 above.

on the activities of the franchisee. However this is only part of the revenue earned from the business, with the balance of the revenue going to the franchisee.

b. However once the market is established, the franchisor has an incentive to terminate the original franchisee to do one of three things:

    i. Take over the operation as a company-owned operation and capture all of the revenue generated by the business.

    ii. Sell the franchise to a new franchisee and benefit from any new entry fees paid to acquire the business – this is sometimes called "franchisee churn".

    iii. Charge a higher "price" to the new franchisee (through increased fees or royalties) than that paid by the old franchisee. This "price" is justified on the basis that the new franchisee faces a lower risk by moving into an established market, compared with the original franchisee who had taken on the risk of establishing that market.

43. Applied to the non-renewal situation, the economic literature suggests that "franchisor opportunism" may come at a longer-term cost of underinvestment by franchisees.[17] This can happen in at least two possible ways:

    a. Potential franchisees may be reluctant to acquire franchises from a franchisor that has a history of behaving opportunistically, assuming that there is a general awareness of the opportunistic behaviour. This may not matter to a franchisor which has decided to decrease its franchising operations in favour of company owned operations.

    b. Existing franchisees may become reluctant to invest or reinvest in the business, because of the uncertainty about whether they will recover their investment in the absence of any guaranteed compensation on expiry or guaranteed right of renewal. This problem of underinvestment:

        i. Is sub-optimal from the point of economic policy and maximising general economic efficiency;

        ii. May cause short-term loss of revenue for the franchisor;

[17] Blair & Lafontaine, The Economics of Franchising, *op. cit.*, pp. 266-268 demonstrate mathematically why a franchisee's investment decisions are affected by the length of the renewal period and the probability of renewal, as well as the availability of buy-back options.

iii. Is likely to cause long-term problems for the franchisor and its reputation, because it will not attract the best potential franchisees for its system.

44. Empirical evidence and the economic literature suggest that in general franchisors will renew franchise agreements to avoid the adverse consequences of opportunism.[18] This may explain why, as previously mentioned, evidence collected in both Australia and the US suggests that renewal rates exceed the 90% level. Blair & Lafontaine express the opinion as follows:

> "We conclude that in terms of non-renewals and termination, as with other aspects of the contract, the benefits of "mistreating" franchisees is typically low, and the cost of doing so can be quite high.
>
> Having said all this, it is important to recognise also that reputation effects do not discipline all franchisors to the same extent..."

45. Put another way, just because a franchisor may have an incentive not to engage in opportunistic behaviour does not mean that opportunistic behaviour will not occur. If the benefit to the franchisor of acting opportunistically is high enough, it would be rational for the franchisor to act in this way even though it may suffer some financial or reputational cost.

46. Whilst the threat of non-renewal remains as a possibility, it is a powerful weapon in the hands of a franchisor to extract benefits or concessions from franchisees. Indeed one of the main arguments advanced against regulation is to preserve the ability of franchisors to threaten franchisees with non-renewal. This argument is summarised by Brickley et al, as follows:

> "Good cause provisions increase the costs of terminating units and thus potentially reduce the threat of termination (the laws require increased payments to the franchisee unless good cause can be documented in court, which is expensive). Hence franchisees will have an increased incentive to free ride, and the costs of controlling quality are likely to increase. If the laws do increase the costs of franchising relative to company ownership, franchisors would shift marginal operators toward central ownership."[19]

However, the authors ultimately conclude, based on their empirical studies, that the laws restricting termination do not greatly affect industries other than those which are prone to serving

[18] Blair & Lafontaine, The Economics of Franchising, *op. cit.*, p.274.
[19] J.A. Brickley et at, The Economic Effect of Franchise Termination Laws", *Journal of Law and Economics*, vol. 34, April 1991, pp. 101-132.

transient customers. They also conclude that where these laws were adopted they involved a transfer of wealth away from the stockholders of franchised companies to franchisees.[20]

47. As a reason not to adopt protections against non-renewal, the arguments identified by Brickley et al are not compelling from a policy point of view, in the Australian franchising context:

    a. There has been no noticeable trend away from franchising and indeed franchising continues to thrive in Australia, despite the introduction of the provisions regulating termination rights in the Franchising Code.21

    b. To the extent that restrictions on the ability not to renew a franchise agreement may be described as "passive termination", it should be regulated in the same way as other forms of termination are regulated by the Code.

    c. Thus, it is highly questionable whether there would be any adverse economic consequences if the right of non-renewal was regulated. Where franchisors act in good faith to renew franchise agreements, whether motivated by the incentives mentioned earlier or otherwise, there will be no regulatory cost. The only regulatory cost will be borne by those franchisors who would otherwise seek to act opportunistically.

    d. Even if there were an adverse regulatory cost for franchisors who would otherwise act opportunistically, it would need to be balanced against the economic costs of non-regulation, namely underinvestment in the franchise industry because franchisees are uncertain about their ability to recoup their ongoing investment in the business. In this case, the greater good would be served by eliminating the uncertainty which affects all franchisees, rather than eliminating the costs that may be suffered by those franchisors that would otherwise be prepared to act opportunistically.

48. Any analysis of economic costs would also need to take into account the actual costs incurred by a franchisee where opportunistic behaviour occurs. Not only has this conduct occurred in relation to CFAL, but there are also other cases found in the law reports which indicate the range of

[20] Brickely et al's empirical observation about the transfer of wealth would appear to parallel an observation in the Productivity Commission Draft Report on Retail Leasing that mandatory renewal clauses appear to produce lower rents. The Productivity Commission said that the reason for this was unclear, although it questioned whether the lower rents occurred due to the inability of the landlords to replace poorly performing tenants. However, an equally plausible explanation is that where a landlord can act opportunistically it can exploit an economic rent equivalent to the opportunity cost to the tenant of exercising its alternative course of action to move its existing business to a new location. If so, the argument about whether or not protections should be instituted to stop opportunistic behaviour at renewal occasions is simply an argument about whether it is the landlord or the tenant that should benefit from the wealth created by the tenant's success during the rental term.

[21] This was the conclusion drawn by the Griffith University in L. Frazer et al, *Franchising Australia 2006*, p.8.

opportunistic behaviours that can and have been used by franchisors (or landlords). These examples indicate that it is not simply a theoretical problem, but is one that has practical and costly consequences:

a. The Rockingham example shows how franchisors may attempt to profit from the threat of non-renewal to obtain a forced sale of franchise units at a significant undervalue. The true economic cost in this case is that a successful business operation at KFC Rockingham was needlessly closed, to the detriment of the franchisee, the employees, suppliers and customers – all of whom were powerless to stop the closure. A further measure of the potential costs involved is the offer by the franchisee to share profits with the franchisor (which would not have otherwise occurred) during an interim period to keep the restaurant open.

b. The case of Ranoa Pty Ltd v BP Oil Distribution Ltd (1989) 91 ALR 251 was a case where BP refused to renew a petrol station franchise at Engadine, so that it could operate the site itself without paying any compensation to the operator who had built up that business. BP gave that notice so as take possession of the business immediately after the statutory 9 year protection period under the PFMRA expired. In its judgment the Court acknowledged:

> "A franchisee such as the appellant ... may regard this result as harsh, the harshness being exacerbated if it should be the case – we do not know whether it is so – that franchisors are more likely to decide themselves to operate sites to which substantial goodwill attaches. But if the result is harsh, it is a product of the circumstances that the Act does not require the franchisor who elects not to renew to pay any compensation to the franchisee." (at [28])

c. The case of ACCC v Berbatis (2003) 214 CLR 51, involved the owners of a fish and chips shop at Farrington Fayre in Leeming, WA, who were forced to withdraw legal action against the landlord in order to obtain a renewal of their lease. In that case, Gleeson CJ held:

> "In the present case, there was neither a special disadvantage on the part of the lessees, nor unconscientious conduct on the part of the lessors. All the people involved in the transaction were business people, concerned to advance or protect their own financial interests. The critical disadvantage from which the lessees suffered was that they had no legal entitlement to a

> renewal or extension of their lease; and they depended upon the lessor's willingness to grant such an extension or renewal for their capacity to sell the goodwill of the business for a substantial price. They were thus compelled to approach the lessors, seeking their agreement to such an extension or renewal, against a background of current claims and litigation in which they were involved. They were at a distinct disadvantage, but there was nothing special about it." (at [15])

49. In fact, the incidence of franchisor opportunism may be underreported, and therefore be hidden in the renewal statistics. As the Berbatis case indicates, the weaker party (whether franchisee or tenant) may simply decide to comply with the demands made by the stronger party (franchisor or landlord) because the cost of not complying and losing the business may outweigh the costs of giving into the demands. Such an outcome, which involves the giving of effect to unequal bargaining power, cannot be justified as being the workings of an efficient market. The transfer of wealth from the weaker party to the stronger party is an essential cost of allowing franchisor opportunism to flourish. As previously indicated the real problem for franchisees have no real ability to avoid this cost, because they cannot "vote with their feet" unless they want to abandon their business entirely.

50. In summary, the first of the key principles to justify regulatory reform is satisfied. The preceding analysis indicates that there is a very real economic problem of franchisor opportunism. The problem was anticipated by both the Swanson Committee and the Blunt Committee in the 1970s (although the term "franchisor opportunism" was not used in those reports).[22] The high-profile closure of the Rockingham restaurant, which has had national coverage and is thus anxiously watched by all industry stakeholders, clearly establishes "a case for action" by means of government regulation. Attention must therefore be directed to the second and third principles, which are concerned with identifying regulatory options and implementing reform.

Principles 2, 3: Regulatory Options and Reform

51. There are several approaches that have been taken in Australia and overseas to address the issue of franchisor opportunism, in the context of the non-renewal of franchise agreements:

    a. KFC standard franchise agreement in the United States– a different form of franchise agreement applies to KFC restaurants in the United States. Under this agreement, the franchisee has an automatic right of renewal every ten years provided the restaurant is

[22] Trade Practices Act Review Committee (Swanson Committee), 'Report to the Minister for Business and Consumer Affairs', August 1976, ch. 5; Trade Practices Consultative Committee (Blunt Committee), 'Small Business and the Trade Practices Act', December 1979, ch.11.

upgraded or remodelled, and the franchisee is not otherwise in breach of the existing franchise agreement.

b. Petroleum Industry legislation in Australia – the Federal government enacted the Petroleum Retail Franchise Marketing Act 1979 ("PRFMA") to create a fair environment for franchisees due to dramatic changes that occurred at the time in the oil industry, which included petrol companies terminating or refusing to renew petrol station franchises so they could take over sites to operate as company owned sites.23 Section 17 of the PRFMA, which contained provisions regulating the right of renewal is now encapsulated in clauses 32(6)-(9) of the Oilcode regulations, which replaced the PRFMA.24

c. US legislation – legislation has been introduced in 19 US states to regulate franchise renewals, which are broadly based on the "good cause" principle (explained below). A summary of this legislation is contained in Appendix 2 to the submissions lodged by CFAL with the Productivity Commission in August 2007.25 Although the Matthews Committee report (Attachment E) contains a description of certain foreign franchising laws relating principally to disclosure, the report does not refer to the US renewal statutes.

Agreement and Self-Regulation

52. The best outcome for all parties would be a negotiated outcome as represented by KFC's US franchise agreement. That is because it represents an effective self-regulatory mechanism where the question of investment (ie. store upgrades) is expressly tied to the issue of recoupment of that investment – namely renewal rights and the necessity to remain compliant with the terms of the franchise. Thus, the contract contains its own self-regulating mechanism for "good faith" renewals. Other provisions of that contract assist in this process by limiting the franchisor's rights

[23] An outline history of the circumstances leading to the enactment of the PRFMA is contained in the Blunt Committee report, paras 11.5-11.10. An example of the type of conduct engaged in by the oil companies can be seen in the case of Ranoa v BP Oil (1989) 91 ALR 251. However, that case also illustrates one of the limitations of s.7 of the PRFMA, namely a 9 year time limit – with BP moving to eject the franchisee from the premises immediately after the 9 year limit expired. The use of a minimum time limit may reflect the special nature of petrol station franchises, which appear to be based on a lease of the petrol station site itself, so that a petrol station franchise in some respects is more like a retail lease than a typical franchise agreement applicable to franchisees such as CFAL. So far as ordinary franchises are concerned, the Blunt Committee rejected the notion of minimum franchise terms: Blunt Committee report, *op. cit.*, para 11.49.

[24] Trade Practices (Industry Codes – Oilcode) Regulations 2006.

[25] A useful synopsis of these provisions and their operation is contained in C.R. Tractenberg et al, 'Legal Considerations in Franchise Renewals', *Franchise Law Journal*, Spring 2004, pp.198-210. Note also that there are a number of industry specific statutes in the US, eg. in the oil and automotive industries, most of which require good cause for termination or non-renewal Blair & Lafontaine, *op. cit.*, p.279.

in relation to the type of upgrades required and the royalties payable on renewal. Regrettably, in the absence of regulation, this type of agreement represents the exception and not the rule.[26]

Reforming the Franchise Code

53. Where legislation has been introduced, it has sought to establish a level playing field between franchisor and franchisee by creating a mandatory right of renewal, unless the franchisor has a good faith or good cause reason for not renewing. In this context, good faith or good cause does not favour either the franchisor or franchisee, nor does it mean that parties are locked into a business or business model for an indefinite period. What it does avoid, however, is the market distortions associated with franchisor opportunism. It is therefore a case of beneficial regulation to improve the efficient workings of the franchising industry.[27]

54. Legislation of this type would ideally be introduced by the Federal government as an amendment to the Franchising Code. This amendment would then operate to benefit all franchisees nationally. In many respects this would be an extension of the existing protections given to franchisees from opportunistic termination of the franchise agreement during the contractual term.

55. CFAL presented a Reform Proposal to the Federal Government on 21 January 2008 which sets out the arguments in support of a change to the Franchising Code. This material draws upon an earlier submission made by CFAL to the Productivity Commission Inquiry into Retail Leasing in September 2007. The solution proposed in that Proposal also obtains support from the earlier Swanson and Blunt Committee reports, which were prepared during the early years of trade practices regulation and the franchise industry in Australia. The Rockingham example provides a clear example why this legislation is now necessary.

Reforming the Unconscionability Provisions

56. As well as changing the Franchising Code, the Rockingham example demonstrates the need for change to the unconscionability provisions of the Trade Practices Act and the State Fair Trading Acts.

---

[26] In may be relevant to note that the use of the current US KFC agreement is due in part to a settlement reached in 1997 of class action proceedings brought against KFC in the United States by the Association of Kentucky Fried Chicken Franchisees, Inc that was commenced in 1989.

[27] This argument is supported by the brief recount of the submissions made by the Trade Practices Commission to the Blunt Committee, which "supported a law to stabilise the relationship" of franchisor and franchisee to remove the ""clogs' on the whole process of competition", including potential loss of goodwill and fear of confrontation. The Committee responded by recommending that termination or non-renewal other than in certain specified situations "would render the franchisor liable for damages for unjust termination or non-renewal: Blunt Committee, *op. cit.*, paras 11.38-11.41, 11.47.

57. There is clearly great uncertainty surrounding the meaning of the term "unconscionable conduct", and hence the effectiveness of the current remedial provisions in relation to unconscionability is questionable. Although the Productivity Commission report contains a draft finding in relation to retail leasing that "threat of action under unconscionability conduct provisions appear to have had an influence on market conduct", it is not at all clear that this finding extends to renewal disputes (in light of the Berbatis decision), as opposed to disputes occurring during the contractual term. The Productivity Commission draft stopped short of recommending that unconscionable conduct be more clearly defined, although the draft finding continues "It is likely that further interpretation and clarification would deliver additional benefits".[28]

58. The only effective form of clarification in relation to the application of unconscionability provisions to contract renewals will be by amendment to the Trade Practices Act/Fair Trading Acts, or by regulation under those Acts. This is a consequence of the High Court's decision in the Berbatis case. As a practical matter, a litigant in the position of CFAL would take a significant risk in bringing a test case under s.51AC that at the very end of the litigious day the High Court would dismiss the claim, and confirm that the ambit of unconscionability under s.51AC was limited in exactly the same way as s.51AA. Any such proceedings may take 5 years or more to resolve as the matter progressed through the court hierarchy, during which costs would mount and uncertainty would prevail for both the franchisor and the franchisee. The only way to short circuit this process is by government regulation.

59. CFAL identified a solution to the unconscionability problem in relation to franchise renewals in its discussions with the Western Australia government in November 2007. Rather than change the terms of s.11 of the Fair Trading Act 1987 (WA), which currently adopt the wording of s.51AC, CFAL proposed that the WA government make a regulation under the Fair Trading Act to clarify that s.11 applied to unconscionable conduct in relation to franchise renewals. This solution would provide the certainty that is currently missing from these provisions, and would have avoided the closure of the Rockingham restaurant.

60. CFAL obtained legal advice about this issue, which was to the effect that the Western Australian government would need to amend the Fair Trading Act to give it the power to make appropriate regulations.[29] This solution is one that the WA government should adopt whether or not the Federal government amends the Franchising Code to deal specifically with the non-renewal issue.

---

[28] Productivity Commission Draft Report, *op. cit.*, p.178.
[29] Advice from Leo A Tsankis, 22 October 2007.

61. The use of the regulation making power would also enable governments to respond quickly and flexibly to other unconscionable conduct situations as they arose, and then allow those situations to be dealt with in the context of an existing legislative framework.

Compensation for Goodwill

62. An additional or alternative measure would involve a requirement that the franchisor compensate the franchisee for the loss of goodwill if the franchisor was not prepared to offer a renewal of the franchise agreement. A number of US states have provision for compensation in the event of non-renewal.[30] The Swanson Committee also considered that compensation should be available as "a private right, to secure fair compensation for [the franchisee's] investment, including goodwill upon termination of their franchises". The Swanson Report expressly included refusal to renew as one of the circumstances justifying the payment of compensation.[31] The Blunt Committee went further by proposing draft legislation that included a right by the Court to "award compensation to a franchisee for unlawful termination or failure to renew a franchise".[32]

63. The rationale for introducing such a requirement is that it would encourage efficient investment by franchisees, because:

    a. It would remove any incentive on the part of the franchisor to act opportunistically and make a profit at the expense of the franchisee. This may be particularly important, for example, in dealing with franchisee churn.

    b. It would ensure that the franchisee's investment was protected in the event that the franchisor made a "good faith" decision not to renew the franchise agreement – eg. if the franchisor wanted to leave the industry, or alter its business model.

64. Defining what is meant by "goodwill" can produce different answers for lawyers, accountants and economists. This problem arises because of the intangible nature of "goodwill". The Productivity Commission Draft Report identifies three components for "goodwill" – location, human capital of the business management, and the product/brand. In one sense the three elements are interdependent, and it is artificial to remove any one of those elements and say that it is the primary cause for the goodwill in the business simply because the removal of that element means that the business can no longer continue in its existing form. Nevertheless, Australian law does

[30] Tractenberg et al, Considerations in Franchise Renewals, *op. cit*, p.204.
[31] Swanson Committee Report, paras 5.7-5.15.
[32] Blunt Committee Report, p.119, para 9(e).

not recognise any goodwill in a lease, and by analogy a franchise, once the agreement has expired.[33]

65. However, there is no reason in principle why a valuation of goodwill should be calculated on the negative assumption that the business must close, rather than the positive assumption that the business can continue. The facts are starkly illustrated by the Rockingham example – as a going concern the business was worth several million dollars on conventional valuation methods, but as an expired restaurant it was only worth the value that could be salvaged from the sale of its tangible assets.

66. Adopting the positive assumption, the true cost of franchisor opportunism can be quantified – being the difference between the value of a renewal (ie. going concern valuation) and the value consequent upon the opportunistic behaviour occurring (ie. closure). Assuming the franchisee was prepared to undertake a renewal in good faith, the value destruction due to closure would be the consequence of the franchisor's conduct and it is the franchisor that should pay the cost of making that decision. Put another way, a decision by the franchisor not to renew could be treated as a compulsory or forced sale of the business, and would occur at market value. In this way, the franchisee could make its investment decisions without facing the uncertainty that the opportunity to recoup the investment would be lost due to a decision by the franchisor over which it had no control. Sale at a market value would ensure that franchisees were not able to obtain compensation for poor business decisions or adverse changes in general market conditions.

67. In the case of franchised restaurants, there is a well established method of valuing restaurants which change hands. Typically this is done by use of a standard multiple applied to the restaurant earnings (EBITDA), which is a relatively well known accounting and business concept. However, the legislation, whether through the Franchising Code, or the state Fair Trading Acts, need not prescribe exactly how the valuation was to be performed. It would be sufficient for the legislation to require that compensation be paid based on the market value of the business as a going concern – ie. not on the basis that the franchise contract was for a limited duration only.

68. Applied to the Rockingham situation, a regulatory mechanism that compensated CFAL for non-renewal of its restaurant would have had the consequence that the restaurant would have remained open – either in CFAL's hands, because there would have been no reason for franchisor opportunism to have occurred, or because the restaurant had been transferred to the franchisor at a market price that reflected its value as a going concern.

---

[33] *Ranoa Pty Ltd v BP Oil, supra*; citing *Llewellyn v Rutherford* (1875) LR 10 CP 456.

Summary

69. Of the three options identified for regulatory reform: Franchising Code amendment, unconscionability provisions and compensation for goodwill, the most effective of these to deal with the problem of franchisor opportunism would be the amendment of the Franchising Code as recently proposed by CFAL to the Federal Government. As previously mentioned, this solution may have the greatest net benefit, by providing greater certainty to franchisees and those who rely upon them in the conduct of their businesses, whilst only penalising those franchisors who would otherwise choose to act opportunistically at the expense of their franchisees. In addition, any such regulation would be supplementary to existing protections provided in clauses 20-22 of the Franchising Code that deal with situations that could amount to franchisor opportunism during the term of the contract.

70. However, amendment to the Fair Trading Act, by the introduction of a regulation making power to assist in the efficacy of the unconscionable conduct provisions, would also be desirable whether or not amendments are made to the Franchising Code. The Rockingham situation required an immediate response in a highly uncertain legal environment. The ability of the government to make regulations quickly and flexibly under such a power would be likely to have resolved the problem before it became too late and the restaurant was forced to close. In the franchise environment, where relational, organic or incomplete contracts necessarily exist, it is to be expected that other situations may well arise in the future calling for regulation which cannot be presently anticipated.

71. CFAL also submits that further consideration should be given to the question of compensation in lieu of a good faith renewal provision. Whilst this option has the dual benefits of greater certainty for franchisees and removal of an incentive for franchisor opportunism, the idea that renewal occasions should provide franchisors with an opportunity to extract a compulsory sale of the business is a matter which could cause strains in the franchisor-franchisee relationship and may be a second best option compared to the amendment to the Franchising Code proposed above.

The Way Forward

72. The problem evidenced by the Rockingham precedent, analysed in this submission, calls for a strong response from both State and Federal governments to close the void in Australian law, and send a clear signal that franchisors cannot act opportunistically against franchisees. As the submission demonstrates, there is a clear case for regulatory reform in this area which satisfies the three key principles for reform that were identified by the Productivity Commission and the Regulation Taskforce.

73. CFAL submits that the appropriate recommendations to be made by each of the Inquiries are:

    a. Endorse the amendment of the Franchising Code by the Federal Government, as proposed by CFAL, that franchisors be required to renew franchise agreements (or pay compensation in lieu) unless they can establish a good faith reason not to renew.

    b. Recommend to the State Government that it amend the Fair Trading Act provisions relating to unconscionability, by inserting a regulation making power to allow the Government to clarify particular situations to which the unconscionability provisions apply, as and when those situations arise.

    c. Recommend that, if the Franchise Code is not amended to deal with the non-renewal issue as proposed above, the State Government make a regulation extending the operation of the unconscionability provisions to include the misuse of a franchisor's power not to renew a franchise agreement as previously proposed to the West Australian government by CFAL.

    d. Recommend that further consideration be given by State and Federal governments to the desirability of introducing provisions in the Franchising Code or Trade Practices Act/Fair Trading Acts for compensation in the event that a franchise agreement is not renewed on expiry.

74. CFAL commends the initiative taken by the West Australian Government and the South Australian Parliamentary Economic and Finance Committee to establish the respective inquiries in relation to franchising, and to allow the defect in Australian franchise law exposed by the closure of CFAL's KFC restaurant at Rockingham to be identified and resolved. As the insights of the Swanson and Blunt committees from the 1970s demonstrate, the problem is not a new one. However, the high profile closure of the Rockingham restaurant has moved this problem from theory to practice, and all governments must now act to remove this void in the interests of all Australians and their families whose livelihood depends directly or indirectly upon a strong and vibrant franchise community.

Competitive Foods Australia Pty Ltd[34]

4 February 2008

[34] This submission has been prepared on behalf of CFAL by Timothy D. Castle B.Ec., LL.B (Syd), B.A. (Hons)(UNE).