FIXING THE VOID IN AUSTRALIAN FRANCHISE LAW:

CFAL SUPPLEMENTARY SUBMISSION: 1997 REID COMMITTEE

Executive Summary

1. This supplementary submission highlights the work done by the Reid Committee in May 1997,[1] in addressing key issues in relation to franchising and unconscionable conduct. Put simply, the conclusions of the Reid Committee provide further evidence and strong support for the recommendations proposed in CFAL's submission to each of the current franchising Inquiries.

2. The Reid Committee report reveals that the current void in Australian franchising law concerning franchise renewals is a consequence of over 30 years of policy failure by successive Australian governments, with the exception of legislative intervention in relation to petrol station franchises, and the enactment of the highly uncertain unconscionability provisions in s.51AC of the Trade Practices Act.

3. At paragraph 6.26 the Reid Committee asked the pertinent question: "why, if the economic and moral case for effective legislative action is so persuasive, Governments have been so reluctant to act". The only answers provided were that it was perceived to be too onerous for franchisors, was an unwarranted interference with the parties' freedom to contract, and introduced uncertainty and an unnecessary regulatory burden. The Reid Committee analysed and rejected those arguments in making a recommendations for its proposed "unfair conduct" law.

Franchising

4. The Reid Committee considered Franchising in chapter 3 of its report. The Reid Committee predated the current mandatory Franchising Code under the Trade Practices Act, although it makes frequent reference to the then current voluntary Franchising Code of Conduct.

5. The following passages in that report are of particular relevance to the present Inquiries:

    a. Paras 3.11-3.16 set out the history of inquiries and reviews into franchising in Australia, commencing with the Swanson committee in 1976, and Blunt committee in 1979. This include reference to problems arising in relation to renewals.

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[1] The Reid Committee was the House of Representatives Standing Committee on Industry, Science and Technology, which provided a report entitled 'Finding a balance: Towards fair trading in Australia' to the Federal Minister for Small Business and Consumer Affairs in May 1997. The Reid Committee Report can be accessed at www.aph.gov.au/house/committee/isr/Fairtrad/report/contents.htm

b. Paras 3.24-3.29 refers to the danger of opportunistic abuse in franchise relationships.

c. Para 3.80-3.82 provide evidence of abuse in franchising relationships. In particular:

> "3.81 The Committee believes that widespread abuses are occurring in practice. It is simply not credible to dismiss all the complaints made to this Commission and to previous inquiries...."

d. Para 3.110-3.111 summarises the Committee's views that there should be specific franchise legislation, that additional protection would be provided by the Committee's proposed "unfair conduct provision" and that there should be an independent code administration body and dispute resolution processes.

6. As mentioned in CFAL's earlier submission, a fundamental problem with the Franchising Code is that it regulates the exercise of termination powers during the contractual term (thus reducing the likelihood of opportunistic terminations), but is silent in relation to renewal rights. The response to this problem, as suggested, is the amendment of the Franchising Code by the Federal Government.

Unconscionable Conduct

7. Chapter 6 of the Reid Committee report deals with legislative protection against "unfair conduct". The Reid Committee's recommendations appear to have led to the introduction of the unconscionability provisions in s.51AC of the Trade Practices Act, and similar provisions adopted in the Fair Trading Acts. The fundamental point of difference between what the Reid Committee recommended, and what was enacted, was the term "unconscionable" replaced the recommended term "unfair" (see Reid Report para 6.73).

8. The Reid report is therefore useful for three reasons: (i) explaining the policy rationale for the introduction of s.51AC; (ii) rejecting the arguments opposing regulatory intervention; and (ii) indentifying what needs to be fixed with s.51AC to enable it to achieve its intended result.

a. Para 6.1 notes the common features of complaints received by the ACCC, including opportunistic behaviour where "the dominant parties seek to vary the nature of the relationship so that it is more favourable to the dominant party" once the parties are committed to that relationship.

b. Para 6.3 identifies the narrow types of circumstances traditionally regarded by the law as constituting "unconscionable conduct".

c. Paras 6.26-6.32 outline the long history of the failure by governments to deal with unfair business conduct in this area, starting with the 1976 Swanson report. The report notes that the usual reason advanced for watering down and abandoning legislation was a belief that it was "too onerous on franchisors and was an unwarranted interference with the parties' freedom to contract". However the Reid Committee's response to these concerns was:

> "6.32 In practice, it has long been recognised that the assumptions underlying the doctrine of freedom of contract – that contracts are based always on the mutual agreement of fully informed individuals and arise out of freedom of choice – cannot be sustained...."

d. Paras 6.33-6.41 contain an analysis and rejection of the argument that the introduction of a new "unfair" conduct law would introduce uncertainty and unnecessary business costs. In summary the Committee concluded that businesses which behaved in good faith would have nothing to fear from the changes, that any costs would be transitional, and that any potential costs of regulation would need to be assessed against the social and economic costs currently occurring due to unfair conduct. These conclusions support the arguments advanced by CFAL for closing the void which now exists in relation to opportunistic franchise renewals.

e. Para 6.55-6.72 indicate a number of options for legislation. It is clear that the Reid Committee thought the description of "unfair" conduct was a superior term to use, compared to various other proposals advanced. However, it appears to have assumed that the term "unfair" was intended to include "harsh or oppressive" conduct as referred to in 6.59-6.60, namely:

> "... the exploitation of 'economically captive' firms where commercial freedom is impaired by the nature of the relationship between the parties giving the corporation opportunity to extract extra-market rents".

As para 6.63 stated the proposal would have dealt with "a class of conduct which should be illegal."

9. The failure of s.51AC and its state equivalents can readily be seen by examining it in the context of the Reid Report. It is far from clear that opportunistic behaviour occurring at the time of renewal of a franchise agreement (or a lease) is illegal under s.51AC, as the Reid Committee intended. CFAL submits that the appropriate course for all governments would be for s.51AC and its Fair Trading Act equivalents to be clarified by further drafting that gives

full effect to the intentions of the Reid Committee, and thereby resolves any doubts that s.51AC also applies to renewal conduct (thereby clarifying also that the Berbatis decision is not applicable to s.51AC claims) or any other opportunistic conduct by a stronger party against a party that was an ‘economic captive’ to that stronger party.

Competitive Foods Australia Pty Ltd[2]

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