

HANSARD 23 JUNE 2011

ECONOMICS AND INDUSTRY STANDING COMMITTEE

Seventh Report — "Inquiry into the Franchising Bill 2010" — Tabling

DR M.D. NAHAN (Riverton) [12.03 pm]: I present for tabling the seventh report of the Economics and Industry Standing Committee entitled "Inquiry into the Franchising Bill 2010". I also table the submissions.

Dr M.D. NAHAN: On 18 November 2010, this house referred the Franchising Bill 2010, a private member's bill introduced by the member for Southern River, to the Economics and Industry Standing Committee for assessment and recommendations. This report provides that assessment. In short, the committee recommends that the bill not be supported, at least at this time. If the Parliament elects to support the bill, the committee recommends a number of amendments to the bill as it currently stands.

The report expresses the view of the majority of the committee, but this is not a unanimous view; the deputy chair, the member for Cannington, has a dissenting review, which is appended as a minority report. The member for Southern River was co-opted to the committee and participated fully in all aspects of the inquiry, but was not able to vote on the committee deliberations. He will no doubt express his view later. The bill adopts into state law the commonwealth Franchising Code of Conduct—hereafter referred to as the code—amended to include a good-faith clause, plus pecuniary penalties for breaches of the code, and applies this to the operations of Western Australian-based franchisees.

The bill gives rise to a number of concerns. First, it deviates from the clarity and efficiency of a national uniform approach to regulation of the franchising sector. Second, in doing so, it shifts enforcement responsibilities and the associated costs, in part, from the commonwealth to the state. Over the last 20 years there has been a steady shift to national uniform regulation of consumer and commercial affairs. This shift has been based on the fact that businesses and consumers operate in national or international markets and, as such, are best regulated on a uniform basis across the nation. Franchising is no exception. Most franchises operate across multiple jurisdictions.

The shift to national regulations has received bipartisan support by successive Western Australian governments. The committee was very supportive of the national approach to the regulation of commerce and consumer affairs in general, and specifically as it applies to franchising. Although regulatory powers have shifted to the national level, state governments, including Western Australia's, still play a role in the development and administration of these regulations, and states maintain the right to enact their own different regulations, such as the bill proposes to do.

In this context, the committee found that Parliament is fully within its rights to pass the bill and that that is not inconsistent with the commonwealth code. However, it was the committee's strong view that there must be compelling reasons to deviate from the national approach and introduce state-based legislation. It was also the view of the committee that the case for the bill, and the divergence from the national approach, is not sufficiently compelling at this time.

The franchising sector has been the subject of regular review, with eight government or parliamentary inquiries at state and commonwealth level over the last 30 years. Four of these inquiries were conducted within the last five years.

This included the Bothams inquiry commissioned by the previous Western Australian Labor government and completed in 2008. It is noteworthy that although the Bothams inquiry clearly recommended reform to the franchising sector, it did not support separate, stand-alone state regulation. Clearly, there were, and are, problems in the franchising sector; the various reviews make this clear. Nonetheless, evidence and the conclusions drawn from these inquiries indicate that although instances of misconduct in the franchising sector are serious, they are not widespread.

The evidence from the Australian Competition and Consumer Commission is that the level of complaints to it about the franchising sector have, if anything, declined in recent years. That does not mean that there is no issue.

The commonwealth has responded to the various inquiries with extensive regulatory reform and actions. In 1998 the commonwealth legislated for compulsory registration of all franchisors under a mandatory code of conduct. In 2008, following the Matthews review, the commonwealth government amended the code to incorporate 31 recommendations of that review. In 2010, the commonwealth amended the code to incorporate nine of the 11 recommendations by the federal Ripoll report.

The 2010 amendments also included seven of the recommendations of the Bothams inquiry. Over the period from 2008 to 2010, the commonwealth incorporated into the code the lion's share of the substantive recommendations made by the various state and federal reviews. Changes to the code included wide-ranging requirements to improve the transparency, the quality and the timeliness of disclosure of information to franchisors and to prospective franchisees. The changes were also designed to give prospective franchisees even greater understanding of the risks and obligations of a franchise agreement.

In addition to responding to the reviews, in 2008 the commonwealth established an expert panel to advise on ways to strengthen the statutory unconscionable conduct powers of the Competition and Consumer Act and to further strengthen the Franchising Code of Conduct. In response, the commonwealth made a number of additional changes to the code particularly on franchisee liabilities, and made changes to the Competition and Consumer Act. Responsibility for compliance and enforcement of the code rests with the Australian Competition and Consumer Commission.

The ACCC's enforcement and compliance efforts have been criticised in most of the reviews. In response to those complaints, the federal government gave the ACCC a range of additional investigative and enforcement powers through changes to the Competition and Consumer Act and the Australian Consumer Law. These include direct remedies, such as public warning notices to franchisors, and redress orders, through remedies for breaches under the Competition and Consumer Act. Amendments were also made to the act to clarify the unconscionable conduct provisions.

The commonwealth also gave the ACCC the right to issue infringement notices and penalties, and the power to undertake random audits and monitoring. The commonwealth has also responded to the reviews by increasing its investment in franchisee education through both the ACCC and various training organisations and universities. The lack of knowledge of franchisees prior to entering into franchise arrangements was a crucial problem identified by the reviews. The commonwealth has responded in a comprehensive manner to the various reviews and the identified problems in the franchising sector. It is the view of the committee that these changes mark a significant shift and improvement in the regulation of the sector.

The two key recommendations of the various reviews that were not taken up or implemented by the commonwealth were the inclusion in the code of a good faith clause and pecuniary penalties for breaches of the code. This is what the Franchising Bill 2010 is designed to do. The commonwealth decided, after extensive deliberations, to not include a good faith clause in the code. While the commonwealth was not opposed to the principle of parties acting in good faith, it was not convinced that the term could be operably defined to be effective in mandatory industrial codes.

It was also the view of the commonwealth that the law on good faith is still evolving, and that the inclusion of a good faith clause in the code would create uncertainty and potentially have adverse consequences for franchisees. Instead, the commonwealth chose to amend the code to directly target commonly cited behaviours and to directly improve the power imbalance of franchise agreements towards franchisees. A key area addressed in this respect was end-of-term arrangements, which was a critical problem. A second strategy in lieu of a good faith clause was the inclusion in the code of five desirable behaviours that all parties need to demonstrate to be seen to be attempting to resolve disputes under the code.

All parties to contracts in Australia, including franchise arrangements, have an obligation under common law to act in good faith. To clarify this, the commonwealth altered the code to confirm that nothing would limit implied common law obligations to act in good faith in franchise arrangements. The commonwealth also did not include pecuniary penalties in the code. Its rationale was that it does not believe that civil penalties are appropriate for breaches of industrial codes, such as the code in question, which are meant to be light-touch regulation. It also does not include those penalties in other industrial codes. Moreover, it increased the pecuniary penalties in the Consumer and Competition Act to over \$1 million for businesses. The commonwealth did state that it will review this decision in the context of a wider review of franchise regulations in 2013.

The committee was of the view that the full suite of amendments that have been implemented over the last three years to the code, the Competition and Consumer Act and the Australian Consumer Law, which is a very wide reform that was gazetted in January 2011, address many, indeed most, of the identified problems and will lift the standards of conduct in the franchise industry in Western Australia and around Australia. The committee did not take a position on whether a good faith clause and civil penalties should be incorporated in the commonwealth code, because this was really outside our terms of reference. Nonetheless, I am relaxed about the inclusion in the federal code of both a good faith clause and pecuniary principles.

I believe most, if not all, members of the committee would agree with that. Importantly, the commonwealth has agreed to undertake a review of the regulatory framework of the franchising sector, including all recent changes to the code, the Competition and Consumer Act and the Australian Consumer Law. That will be undertaken in 2013, which is 18 months away. The commonwealth has decided to do that because there are still outstanding issues. The commonwealth has made a large number of changes and wants the dust to settle, as it were, to provide enough time for the review to be based on evidence. The commonwealth has agreed to include a consideration of pecuniary penalties in that review.

The committee was of the view that the Franchising Bill 2010 would provide little benefit to franchisees prior to the implementation of the 2013 review. In the main, benefits would arise from the enactment of this bill by providing an alternative route from the commonwealth legislation for parties in Western Australia to seek redress through the courts for acts of bad faith and breaches of the code. To be effective, the bill would require action to be taken in the courts so that a body of case law could be developed on the definition or interpretation of "good faith" as defined in the bill. This would take time.

Judging from similar actions at the commonwealth level, it would take a very long time. It would also be an uncertain and costly path. It is unlikely—I believe impossible—that the court ruling and adequate case law could possibly be developed before changes to the commonwealth code are considered in 2013 and subsequently enacted, even if this bill were expeditiously enacted by this house and the upper house. The bill, if enacted, is likely to impose substantial costs on the state. It will shift responsibility for enforcement through the courts in part from the ACCC to a state agency.

If it does not, it will have no benefit. According to departmental estimates, there will be a minimum requirement of just over \$4 million over the next four years to discharge the expanded responsibilities foreseen under the bill. Given the appropriateness of maintaining a uniform national regulatory system for franchises; the multiple changes to the national regulatory framework over the last three years; the commitment by the commonwealth to a wide-ranging review of these regulations in 2013; the limited potential of the bill, at least in the near term; and the expected cost from the shift in responsibility from the commonwealth to the state, the committee recommends that the bill not be supported at this time.

The committee also recommends that the Minister for Commerce consider recommending to the commonwealth inclusion of a good faith clause and civil penalties in the commonwealth code in the context of the 2013 review. I believe—this is a personal statement—that if the commonwealth does not include a good faith clause and civil penalties in the code post-2013, then this bill should be reconsidered by a future Parliament.

The committee is of the view that the major impediment to justice and the resolution of disputes in the franchising sector is the cost of accessing courts, particularly for small franchisees. Good faith provisions, such as those included in the bill, rely on access to the courts and are vague and open to interpretation. Therefore, they will not significantly improve access to justice. I strongly believe that franchisees, and particularly small franchisees, will benefit much more from a well-resourced Small Business Commissioner than from the enactment of this bill. I believe that supporters of the bill have, in some public evidence provided to the committee and in evidence provided to me and others personally, overstated the potential coverage and benefits of this bill.

I am sure that many members will receive this. The committee received many media and other references to disputes in the franchising sector as evidence of the need for the bill that implied that the bill would address, resolve or prevent the actions giving rise to these particular disputes. Although I do not in any way dispute the arguments presented or the reality of the harm inflicted on franchisees and their families, it is clear that bill would not address, resolve or prevent many, if not most, of the disputes identified.

The bill will not and cannot prevent or address the harm to franchisees from franchisors going bankrupt. This is a real problem; when a franchisor goes bankrupt, it affects many franchisees. Unfortunately, franchisees are low in the pecking order for rights and access to the assets. This is a major issue that this bill does not address. If members look through the evidence, they can see that the majority of these complaints relate to franchisor bankruptcies.

The bill will not prevent or address the very real problems that arise from financial failure of franchisees or franchisees failing to undertake adequate due diligence before entering into a franchise arrangement. That is another source of the major issues in this evidence. The code will help address some of these issues and some of the changes have been put in place to mitigate these risks.

I believe that much more needs to be done by the commonwealth, particularly with bankruptcy. In truth the bill is not designed and cannot be designed to address these issues. One issue that commonly arose and for which a great deal of effort was made, is the definition of "good faith". The bill adopts a very narrow definition of "good faith". The bill defines "good faith" as "acting fairly, honestly, reasonably, and cooperatively". The proponents of the bill argue that this narrow definition encompasses the general understanding of "good faith" gleaned from case law, and that the use of a narrow definition would provide operation guides to franchisee and franchisors in the carriage of the business.

Most experts who gave evidence to the committee disagreed with this view. Most experts considered the concept of good faith to be unsettled and not open to narrow definition. The general view was that a narrow definition would not provide the clarity intended and could result in excessively narrow interpretation that would not provide effective guidance to participants in franchise agreements. One of the main reasons for the bill was the recognition that there are problems in franchises, but they really arise from the actions of a few rogue franchisors. I probably accept that description though it is emotive.

If the problem lies with rogue franchisors, I do not think a specification of the details of "good faith" in the code of conduct will change their behaviour at all; rogues do not act in good faith. To this end, the committee recommends that if the bill is to proceed, it should be amended to include a general obligation to act in good faith or, if Parliament wants to have a narrow definition, it should change the word "means" to "includes" to broaden the range of issues to be included.

I thank Tim Hughes, principal research officer, and research officers Kristy Bryden and Foreman Foto. I also thank the members of the committee. Even though there were disagreements between committee members, the committee acted in an overwhelmingly constructive and objective manner.

I recommend this report to the house and urge members to read the bill before and during the consideration of the bill in this house.