

Minerva Access is the Institutional Repository of The University of Melbourne

Author/s:

Hardy, T

Title:

Inquiry into the Operation and Effectiveness of the Franchising Code of Conduct:
Submission

Date:

2018

Citation:

Hardy, T. (2018). Inquiry into the Operation and Effectiveness of the Franchising Code of Conduct: Submission. The Centre for Employment and Labour Relations Law, Melbourne Law School.

Persistent Link:

<https://hdl.handle.net/11343/265767>

AUSTRALIAN GOVERNMENT
PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**INQUIRY INTO THE OPERATION AND EFFECTIVENESS OF THE FRANCHISING CODE OF
CONDUCT**

Submission

**Dr Tess Hardy
Centre for Employment and Labour Relations Law
Melbourne Law School
May 2018**

1. Introduction

I am grateful for the opportunity to make this submission. I have long been interested in questions relating to the effective regulation of work within franchises,¹ and have just embarked on a major research project, funded by the Australian Research Council, which will be exploring these issues in much more detail.² Although my research focus is on work quality within franchise networks, the various scandals which have ensued in the past three years have underlined the fact that this issue cannot be addressed through labour law alone.³ Rather, a much more holistic approach must be taken.

For example, in considering what features of the franchise model appear to facilitate, or inhibit, employer non-compliance with workplace standards – one must inevitably consider the vulnerabilities inherent not only within the employment relationship, but in the franchising relationship. Another critical issue – and one which is particularly relevant to the current inquiry – is the extent to which the Franchising Code of Conduct (**Franchising Code**) and the Australian Consumer Law (**ACL**) may contribute to, or curtail, problems of worker exploitation within franchises. It is crucial that greater attention is paid to the complex interplay between workplace and competition and consumer regulation so as to better ensure that all firms are clear as to their relevant legal responsibilities and key stakeholders, including franchisees and employees, enjoy the benefit of important statutory protections.

2. The Challenge of Regulating Franchising

Business format franchising is frequently seen as attractive to franchisees as it provides small business owners, many with limited commercial experience, with the opportunity to ‘be their own boss’, while operating a business under a known and trusted name. For franchisors, allowing independent businesses an opportunity to franchise, provides the franchisor with investment capital and a greater capacity to grow the franchise with minimal risk or cost.

Undoubtedly, franchising is an important part of the Australian economy. When it works well, it has the potential to deliver benefits to a range of stakeholders, including franchisors, franchisees, employees, investors and shareholders. However, it is increasingly evident that the franchising model may, in some instances, perpetuate questionable business practices and produce poor outcomes, particularly for the most vulnerable parties in these networks, namely franchisees (and their employees).

¹ Tess Hardy, ‘Good Call: Extending Liability for Employment Contraventions beyond the Direct Employer’ in Ron Levy, Molly O’Brien, Simon Rice, Pauline Ridge and Margaret Thornton (eds) *New Directions for Law in Australia: Essays in Contemporary Law Reform* (ANU Press, 2017) 71-82; Tess Hardy, ‘Reconsidering the Notion of Employer in the Era of the Fissured Workplace: Traversing the Legislative Landscape in Australia’ in Hiroya Nakakubo and Takashi Araki (eds) *The Notion of Employer in the Era of the Fissured Workplace: Should Labour Law Responsibilities Exceed the Boundary of the Legal Entity* (Kluwer Law, 2017) 47-72; Tess Hardy, ‘Who Should be Held Liable for Workplace Contraventions and on What Basis?’ (2016) 29 *Australian Journal of Labour Law* 78; Tess Hardy, ‘Brandishing the Brand: Enhancing Employer Compliance through the Regulatory Enrolment of Franchisors’ (Paper presented at the Labour Law Research Network Conference, Amsterdam, 25-27 June 2015); Tess Hardy, ‘Big Brands, Big Responsibilities? A Cross-Jurisdictional Review of the Regulation of Work in Franchises’, presented at the Labour Law Research Network Conference, Toronto, 25-27 June 2017; Tess Hardy, ‘Can 7-Eleven be trusted to clean up its own mess?’, *The Conversation*, 13 May 2016; Tess Hardy, ‘Franchising – all care and no responsibility’, *The Conversation*, 29 October 2015.

² Australian Research Council Discovery Early Career Research Fellow: DE180100279, ‘Work in Franchises: Searching for Solutions at the Regulatory Frontier’.

³ But see *Fair Work Amendment (Protecting Vulnerable Workers) Act 2017* (Cth).

In order to promote a healthy and fair franchise sector, and ensure quality working conditions within franchise networks, it is necessary to confront the fact that ‘many franchisees occupy an intermediate position between wages labour and capital.’⁴ Indeed, in the late 1970s, Paul Rubin – a US economist – argued that while a franchisor and franchisee may be legally separate entities ‘the economics of the situation are such that the franchisee is in fact closer to being an employee of the franchisor than to being an independent entrepreneur’.⁵ This observation is not only relevant to franchisees who may be self-employed (which is common in home services and cleaning sectors), but to franchisees who are themselves employers of others (which is frequently the case in sectors such as fast food and fuel retail).

Indeed, while there are some obvious differences between franchise and employment relationships, there are a number of parallels. Broadly-speaking, they are both: relational, long-term contracts; characterised by an inherent inequality of bargaining power; and frequently governed by standard forms contracts prepared by the stronger party (i.e. franchisors and employers respectively). In light of these similarities, the differences between the regulatory regimes which govern franchising, as compared to employment, are striking.

3. Key Regulatory Gaps

Limited Grounds on which to Challenge Franchisors’ Exercise of Discretionary Contractual Powers

Franchisors are under no legal obligation to consult franchisees about decisions which may affect the viability and profitability of the franchisee’s business. Moreover, there are very few grounds on which franchisees may challenge the franchisor’s contractual rights to vary the business model, corporate strategy, franchise territory, store layout or the price of key products, even if the exercise of these discretionary powers is to the detriment of the franchisee (in isolation or as a collective).

Relevant provisions of the Franchising Code and the ACL which are directed at counterbalancing the franchisors’ rights in this respect appear to be inadequate.

First, while the provisions relating to ‘unfair contract terms’ prescribed in Part 2-3 of the ACL have now been extended to small business contracts, many franchisees do not fall within the relevant statutory definition (either because they employ more than 20 employees or the initial capital investment exceeds the relevant thresholds).⁶

Second, the requirement that franchisors comply with implied duties of good faith and reasonableness⁷ and the statutory prohibition against engaging in unconscionable conduct seems to be of limited utility in light of the recent decision in *Virk Pty Ltd v Yum! Restaurants Australia Pty Ltd*.⁸ The franchisee in this decision is seeking the right to appeal to the High Court of Australia and a special leave hearing is scheduled for 18 May 2018.

⁴ Laura Bennett, *Making Labour Law in Australia: Industrial Relations, Politics and Law* (The Law Book Co, 1994) 179.

⁵ Catherine Ruckelshaus et al, ‘Who’s the Boss: Restoring Accountability for Labor Standards in Outsourced Work’ (National Employment Law Project, Report, 2014) 11.

⁶ ‘Small business contracts’ are defined to include contracts where: at least one party is a business that employs less than 20 people; the upfront price payable under the contract is \$300,000 or less (or \$1,000,000 or less if the contract is for more than 12 months); and the contract is a standard form contract.

⁷ These duties may be implied into the franchise contract at common law. Application of these implied terms to franchise contracts is further reinforced by clause 6 of the Franchising Code.

⁸ [2017] FCAFC 190.

Third, the ability of franchisees to question unilateral decisions made by the franchisor is further constrained by the limits placed on collective action under the *Competition and Consumer Act 2010* (Cth) (**CC Act**). Although franchisees have a right to freely associate under the Franchising Code, it is unclear what actions (if any) franchisees may legitimately take in pursuit of their freedom of association. In addition to a number of common law obstacles, the CC Act further restricts the rights of franchisees to take collective action as such conduct is generally perceived as contravening the anti-competitive provisions of the CC Act.⁹ While it is possible to seek an exemption from these provisions by application to the Australian Competition and Consumer Commission (**ACCC**), such an exemption has been sought and granted only sparingly.¹⁰ The uncertainty over the possibility of collective action extends to a question of whether groups of franchisees are entitled to participate in collective mediation under the Franchising Code.

Inadequate Protection from 'Unfair' or 'Harsh' Termination of the Franchise Agreement

While the Franchising Code circumscribes the termination rights of the franchisor in some respects, the franchisee cannot easily challenge termination of the franchise agreement, particularly where it is exercised in accordance with an express contractual term. Termination of the franchise agreement can have devastating consequences for the franchisee. Indeed, the threat or exercise of a right of termination may be an important way in which to encourage or coerce employment law compliance amongst franchisees. These types of commercial sanctions are often far more powerful than legal penalties in terms of driving long-term behavioural change among potentially wayward franchisees.

But with greater power must come greater responsibility. Indeed, it is critical to ensure that franchisors and national master franchisors of overseas brands do not wield their termination powers unfairly – particularly where it is the franchisor's business model which may have contributed to the franchisees' concerning compliance behaviour in the first place. The current regulatory regime does not necessarily allow for consideration of the fact that a franchisee may have failed to comply with relevant legal obligations (such as a provision of the franchise agreement or a term of a modern award) due to decisions taken by the franchisor (e.g. the business model, fee structure etc).

Given this, it is not clear that the present regulatory framework strikes the correct balance between the franchisors' right to effectively oversee and manage the franchise network, the need to promote and ensure workplace relations compliance amongst franchisees and the franchisees' rights to be protected from 'unfair' or 'harsh' termination of their franchise agreement (where the franchisees' breach may be, in part, due to the actions or decisions of the franchisor).¹¹

Compliance and Enforcement Challenges

The regulatory scheme – laid down by the Franchising Code and the ACL – largely assumes that franchisees are able and willing to exercise and enforce their legal rights. However, such assumptions may be misplaced.

⁹ The CC Act prohibits: contracts, arrangements or understandings that have the purpose, or would likely have the effect, of substantially lessening competition; collective refusals to deal with other parties; and cartel behaviour by way of price fixing. See CC Act, ss. 44ZRD, 44ZRF, 45(2).

¹⁰ Shae McCrystal, 'Collective Bargaining Beyond the Boundaries of Employment: A Comparative Analysis' (2014) 37(3) *Melbourne University Law Review* 662.

¹¹ In comparison, in the context of employment relationships, the Fair Work Commission is at greater liberty to take into account the full range of circumstances in determining whether termination of employment is 'harsh, unjust or unreasonable'.

For a start, franchisees often suffer from a lack of information and resources. Further, it can be difficult for franchisees to raise grievances with the franchisor – either internally or to an independent third party. Doing so may expose the franchisee to the risk of retaliation or intimidation on the part of the franchisor. Indeed, speaking out publicly may constitute a breach of the franchise agreement and may prompt the franchisor to terminate the franchise agreement.

The FW Act has specific provisions that are designed to reduce the risks associated with exercising a workplace right by shielding complainants from ‘adverse action’ on the part of the alleged perpetrator.¹² The absence of any equivalent provisions in the CC Act, the Franchising Code or the ACL significantly weakens the ability for ‘whistleblowers’ to raise legitimate concerns about the conduct of the franchisor and makes it more difficult for outsiders, such as the Australian Competition and Consumer Commission or ASIC, to identify and address systemic problems plaguing particular franchise networks.

Another potential barrier to effective compliance and enforcement is the encouragement of self-help remedies, including mediation. While dispute resolution processes may be quick and cost-effective, the absence of any independent decision-maker (other than via the formal court system) represents a key weakness of the current model. The lack of access to publicly funded arbitration¹³ in the context of franchising disputes may mean that franchisees are potentially under more pressure to surrender their legal rights in order to avoid the evidentiary problems, costs, and stress associated with bringing litigation against a well-resourced respondent. Moreover, the inability to bring disputes on a collective basis means that franchising disputes are often privatised and individualised. The confidential nature of the mediation process, combined with the default position of mediator neutrality, can have the effect of masking the vastly unequal power dynamics embedded within the relationship between the franchisor and the franchisee.

4. Regulatory Inconsistencies

Identifying whether or not a particular firm is covered by sector-specific regulation is not a straightforward task given that the definition of franchising under various statutory schemes is not consistent. There are now different definitions of franchising under the CC Act, the FW Act and the *Corporations Act 2001* (Cth). This can make it more difficult for franchisors and franchisees to ascertain whether they have any rights and responsibilities under these respective statutory regimes. It may also have the effect of encouraging regulatory avoidance strategies in some instances.

5. Transparency Issues

The Australian franchising sector suffers from a severe lack of transparency. This is partly due to the fact that there is no requirement for franchisors to identify themselves as such. There is no public register of franchisees. The fact that most franchisees operate through a corporate vehicle under a name that may (or may not) feature the brand name of the overarching franchise system makes it difficult to readily identify how many franchisees are currently active in the network. Holding companies, fund managers and private equity investors are largely hidden from view.

¹² Adverse action may include actions which would otherwise be ‘perfectly lawful’, including making, varying or terminating contracts.

¹³ While arbitration is not necessarily mandated under the FW Act, it is a prominent feature of the dispute resolution model administered by the Fair Work Commission.

Nationwide surveys of the franchise sector undertaken by the Franchising Centre of Excellence are valuable, but ultimately they are undertaken on a voluntary basis, survey only franchisors and response rates are variable. It is recommended that statutory amendments are introduced which require the franchisor to disclose and publicly display critical information, such as: the full name of the franchisor; any 'associates'; and a complete list of current and former franchisees. The lack of any publicly accessible database presents a huge challenge for ensuring effective regulation and oversight of the franchising sector.