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DOCTORAL THESIS

The Regulation of the Franchise Relationship in Australia : a Contractual Analysis

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**The Regulation of the Franchise Relationship
in Australia:
A Contractual Analysis**

Presented by

Elizabeth Crawford Spencer

Submitted in fulfilment of the requirements of the degree of

DOCTOR OF PHILOSOPHY

(Ph.D.)

CERTIFICATION

This thesis is submitted to Bond University in fulfilment of the requirement is for the Doctor of Philosophy. This thesis represents my own work and contains no material which has been previously submitted for a degree or diploma at this University or any other institution, except where due acknowledgement is made.

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Date:

Elizabeth Crawford Spencer

20 September 2007

THESIS ABSTRACT

The Regulation of the Franchise Relationship in Australia: A Contractual Analysis

This dissertation examines whether the regulation of the franchise sector is effective in achieving two of the stated goals of the Franchising Code of Conduct. These two goals are redressing the imbalance of power in the relationship and increasing levels of certainty for participants in the sector. Based on the ‘new learning’ in regulation, this dissertation takes an expansive approach to the concept of regulation. It considers how, in a ‘multi-layered system of governance’, the layers of regulation of the franchising sector contribute to these goals. The results of the analysis suggest that private, self-regulation through the layers of market and contract sets up a relationship where there is an imbalance of power in favour of a franchisor and uncertainty for a franchisee. The market interaction between the parties establishes these conditions, which are reinforced by the contract, in particular by the interaction of the standard form and relational qualities of the contract. A public layer of governance, direct intervention in the form of the Franchising Code of Conduct, relies largely on self-regulatory tools such as disclosure and is also ineffective in addressing the imbalance of power in the relationship and in increasing levels of certainty for franchisees. Because neither self-regulatory mechanisms nor legislative intervention achieves the stated goals of redressing imbalance of power and uncertainty in the franchise relationship, the analysis concludes that a reframing of regulation is necessary. The recommended revised regulatory program features collaborative, participative, democratic process to gather and assess good measurements that inform the identification of problems and the selection of tools appropriate to address those problems.

Keywords: *Regulatory theory, regulatory process, instruments and tools of regulation, regulating contract, standard form contract, relational contracting, franchising, imbalance of power, uncertainty in franchising relationship, discretion in franchise contracts, regulation of franchising, lack of information about the franchising sector, use of contract as tool to measure effectiveness of regulation, use of disclosure in regulation of franchising*

PUBLICATIONS ARISING FROM THIS RESEARCH

The conceptual framework of a multi-layered system of governance as applied to franchising was outlined in ‘Regulating Franchising in Australia: Toward a Post-Regulatory State?’ published in the proceedings of the International Society of Franchising 19th Annual Conference (2005).

Chapter Four adapts material that has been published under the title, ‘Standard Form and Relational Aspects of Franchise Contract’, in the proceedings of the 20th Annual International Society of Franchising Conference (2006).

An abbreviated version of Chapter Six has been accepted for publication in a special issue of the *International Review of Applied Economics* on ‘regulation and governance of the firm’ as an article entitled ‘The Efficacy of Disclosure in the Regulation of the Franchise Sector’.

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September 2007

Elizabeth Crawford Spencer

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The United States

Burger King Corp v Rudzewicz 471 US 462 (1985)
Cubic Corp. v Marty 229 2d 828 (Cal. App., 1986)

ABBREVIATIONS

Alternative dispute resolution (ADR)
American Association of Franchisees and Dealers (AAFD)
American Bar Association (ABA)
Australian Chamber of Commerce and Industry (the ACCI)
Australian Competition and Consumer Commission (ACCC)
Department of Public Prosecutions (DPP)
Franchising Policy Council (FPC)
International Institute for the Unification of Private Law (UNIDROIT)
Motor Trades Association of Australia (MTAA)
New South Wales (NSW)
Operations Manual (OM)
Queensland (QLD)
Regulatory Impact Analysis (RIA)
Regulatory Impact Statement (RIS)
The Australian Competition and Consumer Commission (the ACCC)
The European Franchise Federation (the EFF)
The Franchise Council of Australia (the FCA)
The Franchising Code of Conduct (the Code)
The Franchising Code of Practice (the Code of Practice)
The French Franchise Federation (the FFF)
The International Franchise Association (the IFA)
The Office of the Mediation Adviser (the OMA)
The Small Business Development Corporation (the SBDC)
The Trade Practices Act (the TPA)

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Chapter One

Introduction

1.1 HYPOTHESIS AND OBJECTIVE

Since World War II the franchise sector has grown rapidly in many countries in the world.¹ In Australia franchising was estimated to be worth \$128 billion in turnover per year to the national economy, or about fourteen percent of Gross Domestic Product.² Australia reports more franchises per capita than any other nation in the world, three times higher than the number in the United States.³ The sector employs over 600,000 people, a figure that between 2002 and 2004 increased by about fourteen percent and between 2004 and 2006 by about thirteen percent.⁴ Extrapolating from these figures, about one in ten households in Australia is connected with franchising and the number continues to grow.⁵

Franchising is important to the Australian economy and to individual Australians, but more evidence is needed to inform discussion about the sector and its regulation. Franchising is portrayed by industry groups as a vehicle to transform inexperienced

¹ Today the franchise sector employs over 8.5 million people in the US at about 320,000 locations, and accounts for an estimated \$1 trillion in annual retail sales in that country alone; an estimated 40 percent of all retail sales. See <<http://www.newbusinesscentre.com/statistics.html>>. See also the 'Economic Impact of Franchised Business' study conducted for the International Franchising Association Education Foundation by PricewaterhouseCoopers at <<http://www.franchise.org/content.asp?contentid=542>>. The French Franchise Federation website at <<http://www.franchise-fff.com/>> has links to trends in franchising in Europe. In many countries, not only in developed economies where the sector is maturing, but also in developing economies in Africa, South America and Asia, the sector is expected to continue to grow over the next 10 years.

² Lorelle Frazer, Scott Weaven and Owen Wright, *Franchising Australia 2006 Survey*, Franchise Council of Australia Survey, Griffith University and the Franchise Council of Australia Ltd., <<http://www.franchise.org.au/content/?id=182>> at 14 September 2007. See also <http://www.industry.gov.au/assets/documents/itrinternet/Website_information_PDF_version_final_14_Jul0620060714161438.pdf>. Note that reporting of statistics about franchising generally includes the significant contribution of the beverage, oil and automobile manufacturing industries. Even so, it is an important and rapidly growing sector.

³ Franchising Council of Australia, *Facts at a Glance*. accessed at <<http://www.franchise.org.au/content/?id=15>>.

⁴ According to IBIS World's general manager quoted at <<http://www.expense-reduction.com.au/LicencePressClippings.php?clippingsID=54>>, at 18 June 2005. Projections indicate that growth in the sector will moderate, but that it will continue to expand at the rate of 6-8 percent per year over the next several years. The 2004 to 2006 growth rate is taken from the *Franchising Australia 2006 Survey*.

⁵ See <http://www.thefranchiseoffice.com/wst_page4.html> at 1 April 2007.

people into successful business owners. These groups generate surveys, how-to guides, articles and educational materials to promote the benefits of franchising as a way of doing business to prospective franchisees.⁶ On the other hand there seems no shortage of disappointed, would-be entrepreneurs whose experience of franchising leads them to claim it is a form of predation or servitude.⁷ Lee Anstice, a former franchisor and franchisee who now runs a franchise consulting company on the Gold Coast, estimates that over 30 percent of franchise units in Australia fail to turn a profit.⁸ Perhaps not coincidentally, Rupert Barkoff, a franchise lawyer and commentator in the US, has estimated that about a third of franchises in the US fail to make a profit.⁹

Of course, these are only estimates; in fact, no one actually knows. Myths persist in franchising due to a lack of reliable, objective information about the sector. Franchising is an important part of the economy. There is regulation of the franchise relationship in the form of the Franchising Code of Conduct,¹⁰ but it is unclear to what ends and with what results. Because franchising is important and because there is little reliable evidence of its efficacy, the regulation of the sector has been for many years and remains controversial. In 1999 UK lawyer and franchising expert Martin Mendelsohn wrote that, 'Australian regulation makes Australia the least desirable destination in the world for franchise systems...(they) should avoid Australia until

⁶ See the FCA website at <<http://www.franchise.org.au/>> at 17 September 2007. See also Deloitte, Touche and Tohmatsu, *Franchisee Satisfaction Survey* (2004) <<http://www.deloitte.com/dtt/article/0,1002,sid%253D5632%2526cid%253D83113,00.html>> for the 2004 Franchisee Satisfaction Survey carried out in part by the firm of the State Chapter VP of the FCA.

⁷ Websites in the US devoted to the topic of problems in franchising are common, though they are often short-lived. One example has been the www.quiznossucks.com website. See also <<http://www.ripoffreport.com/reports/ripoff1602.htm>> accessed 26 May 2004. A few websites have appeared in Australia as well, despite franchisors' threats of defamation. A website about Pedders has disappeared. In a telephone interview its author, a former Pedders franchisee, says lawsuits related to the franchise and the website have changed his life.

⁸ Personal interview with Lee Anstice, Gold Coast, September 2006.

⁹ Consider also Barkoff's 'rule of thirds' that attracted press attention and controversy in the US. Personal interview with Rupert Barkoff, Brisbane, May 2007.

¹⁰ *Trade Practices (Industry Codes - Franchising) Regulations 1998 (No 162)* (Cth) The Code is available at <[http://www.comlaw.gov.au/comlaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/406979E8E5E0FAD7CA256F71004E4CCF/\\$file/TradePracIndCodeFran1998.rtf](http://www.comlaw.gov.au/comlaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/406979E8E5E0FAD7CA256F71004E4CCF/$file/TradePracIndCodeFran1998.rtf)> at 10 September 2007.

they have nowhere else to go and even then it would be a close call.’¹¹ Professor Andrew Terry, on the other hand, has characterized the regulation of franchising as, ‘the world’s most comprehensive and protective regulatory regime for franchisees’.¹²

However one might characterize it, regulation of the franchise sector has not been proven to be effective. A Regulatory Impact Statement (RIS) was prepared prior to the enactment of the Franchising Code of Conduct but no Regulatory Impact Analysis (RIA) has been conducted since the regulation has been in effect. Officials at the Franchise Council of Australia (the FCA) declare that the Code is doing its job, but another industry group, the Motor Trades Association of Australia (MTAA) does not share this view. The MTAA Small Business Charter of Fairness calls for ‘the strengthening of the Franchising Code of Conduct.’¹³ Some journalists have also suggested that the regulation of franchising could be improved,

‘[T]he current federal Government -- or a future one -- needs to ensure that franchisees are given better protection. ...[there is] is no excuse for governments not to strive for best practice in franchising. We are a few rungs short of that.’¹⁴

Pursuant to publicity of disputes involving Midas, 7-Eleven and Quizno’s Sub franchisees, the effectiveness of the Code again has come into question. In May 2006 a group of Lenard’s franchisees paid a visit to the Minister of Small Business to discuss the problem of misleading or deceptive conduct in franchising. Together with public awareness of problems in other franchise systems, their concerns led the Government to initiate a comprehensive review of disclosure requirements under the Code.¹⁵

¹¹ Martin Mendelsohn, ‘Franchise Regulation – Has the World Gone Mad?’ (1999) 8(1) *Franchise New Zealand*, at 49.

¹² Andrew Terry, *Fending Off Franchise Failure* (2006) Franchising and Own Your Own Business, <<http://www.franchise.net.au/articles/00/0C03ED00.asp>> at 17 May 2006. Because businesses have the perception that the Code imposes onerous obligations on the franchisor, they may seek structures that do not fall within the Code definition. They may, for example, purport to operate simply as licences, distributorships or managed service agreements.

¹³ Item 7, for full charter see <<http://www.mtaa.com.au/policies/MTAA-Charter.pdf>> 28 November 2006.

¹⁴ Peter Switzer, ‘ACCC to rule on Quizno controversy’, *The Australian* (Sydney), 29 August 2006.

¹⁵ 2006 Review of Disclosure, June 27, 2006 (*The Australian Financial Review* - ABIX via COMTEX). See also <<http://minister.industry.gov.au/index.cfm?event=object.showContent&objectID=F08371CB-ACEF-0A67-AC0803BB65BECAUSE514F>> 30 Oct. 06. Submissions for this review closed 15 August 2006.

In light of such controversy the objective of this thesis is to provide information to stakeholders and regulators about the effectiveness of regulation. This dissertation tests the hypothesis that the Franchising Code of Conduct is effective by assessing whether the regulation of franchising is successful in achieving two of its stated goals, addressing the imbalance of power between franchisors and franchisees, and reducing risk and generating growth in the sector by increasing the level of certainty for participants.¹⁶

In 2000 the Australian Competition and Consumer Commission (ACCC) Submission to the Task Force on Industry Self-Regulation noted that ‘one of the most useful items the taskforce process might produce would be a flowchart or checklist to help assess what form of regulation is most appropriate in any given circumstances’.¹⁷ The Fair Trading Codes of Conduct and the Codes of Conduct Policy Framework have made some progress toward this goal, but there is still no ‘clear guide on how to assess the suitability of particular forms of regulation’¹⁸ for practical commercial application. The aim of the research is to provide information which will be useful in decision-making about future directions for regulation of the sector.

1.2 THESIS STATEMENT

Franchising is an important sector of the Australian economy, but its regulation remains a contentious issue. Years of experimentation with the regulation of franchising, as well as numerous reports, revisions and ongoing tinkering with the regulation of franchising have not led to a satisfactory regulatory program for the sector. The most recent evidence of this is the 2006 Review of Disclosure undertaken by the Office of the Minister for Small Business in response to numerous complaints and publicity about abuses in the sector.

This dissertation examines the effectiveness of regulation by asking whether it has achieved the objectives that were established when the Code was first promulgated in 1998. It considers the nature of regulatory activity, and sets out a framework for

¹⁶ Explanatory Statement, *Trade Practices (Industry Codes - Franchising) Regulations 1998 No. 162* (Cth)
<<http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrument1.nsf/framelodgmentattachments/77630AD9222B25BCCA256F73000E7654>> at 9 December 2006.

¹⁷ Australian Competition and Consumer Commission, *Submission to the Taskforce on Industry Self-Regulation* (2000) 16.

¹⁸ *Ibid.*

assessing regulation that involves a broad contextual approach encompassing multiple layers of governance of the relationship, in particular, market, contract and statutory layers. The market layer of governance is characterized by imbalance of power and uncertainty for a franchisee. The contract layer of governance, both in theory and in practice, is also characterized by imbalance of power and uncertainty for a franchisee. This dissertation argues that it is difficult to overstate the significance of the standard form and relational attributes of the contract as these attributes impact on the relationship between franchisor and franchisee. Statutory intervention is another layer of governance. Among its stated goals are the redress of imbalance of power and the provision of greater certainty for participants. The principal tool relied upon by statutory intervention, disclosure, however, is not adequate in theory or in practice to accomplish these goals. Here, too, the standard form and relational nature of the contract and a variety of other factors detract from the efficiency of disclosure.

This dissertation concludes that regulation cannot reinforce or rely upon existing self-regulatory measures to achieve ends that run counter to the conditions that inhere in these instruments such as imbalance of power and uncertainty. Disclosure is a tool that is also self-regulatory in nature, and is insufficient to meet the stated goals. The reliance on self-regulatory measures assumes that participants can support their roles in the regulatory process. This dissertation demonstrates that a franchisee is not a full participant at any stage in the governance of the relationship, and is not properly equipped to fulfil its role in the regulation of the relationship. Given these conditions, abuse is likely to continue. The regulation of the sector is only likely to be effective if it can be reframed according to a process-oriented approach that includes all participants, fully equipped to fulfil their roles at all stages of the governance of the relationship.

1.3 RESEARCH APPROACH

This dissertation began as an exploratory study of the role of contract in the regulation of the franchise sector in Australia. Background research involved an in-depth examination of the regulation of the franchisor/franchisee relationship (hereinafter the franchise relationship) in Australia and the ways in which contracting parties and

regulators govern their interactions.¹⁹ This exploratory part of the research included a review of the business and economics literature about franchising generally, about regulation theory and theories of contract law. It also included a review of court cases and undertakings involving disputes in the franchise sector in Australia, the current sector-specific legislation governing the franchise relationship in Australia, and a review of the literature about the regulation of franchising in Australia. Finally, this aspect of the study was informed by attendance at industry events, conferences, and consultative panels of the regulator, as well as by conversations with industry participants and regulators.

The exploratory aspect of the research led to the development of the hypothesis that the Franchising Code of Conduct is effective. A comparative content analysis of franchise contracts was used to test this hypothesis. The process involved dividing the content of each contract into its distinct terms that could be more easily compared with the equivalent contract terms of the other contracts in the sample. Given the small size of the sample and the diversity among contract terms, the analysis was primarily textual and discursive. Some content analysis uses coding to transform raw data into a standardized form that is amenable to analysis.²⁰ Analysis can be based on the coding of either manifest content (concrete terms) or latent content (underlying meaning), or a combination of the two. It can be a useful method for legal research into contracts because of the importance of written documentation of legal relationships.²¹ In this study, while coding was not the primary component analysis, it was used to test for the frequency and context of certain words or phrases such as reasonableness, good faith and discretion. See Chapter Five for the results of the contract terms analysis.

A purposive sampling method was used in selecting the contracts for analysis.²² Though there is no such thing as a ‘typical’ franchise system, here the aim was to

¹⁹ Extended case study tries to lay out what is expected prior to conducting research. Equipped with a thorough grounding in the literature, the researcher looks for conflicts with existing theories and seeks to fill ‘theoretical gaps and silences’. See Earl Babbie, *The Practice of Social Research* (10th ed, 2004) 293 and Yin, *Case Study Research, Design and Methods* (1984).

²⁰ See <<http://www.gslis.utexas.edu/~palmquis/courses/content.html>> at 10 April 2007.

²¹ One of the questions in the initial stages of this research was whether the contract is sufficiently important to parties in franchising that it would provide an accurate reflection of their interests.

²² A purposive sample is selected by the researcher subjectively with the goal to obtain a sample that is representative of the population. See Robert Ferber, ‘Research by Convenience’ (1977) 4(1) *Journal of Consumer Research*, 57-58.

sample franchise contracts from a selection of different types and sizes of franchise systems in Australia. In this case the sample was an opportunistic sample, selected from membership of the Franchise Council of Australia. The contracts for the content analysis were obtained through written requests to franchisors. Given the small size of the sample as an exploratory study, this purposive sampling method does ensure that there is some qualitative range included in the sample. A total of 45 franchisors on the east coast of Australia were contacted with requests to share their contracts. Of those contacted twelve systems agreed to supply contracts for the study. These contract samples were supplemented with seven contracts obtained from franchisors' solicitors for a total of nineteen contracts in the sample.

The contracts in the sample are from established franchise systems; several in the sample are among the best known franchises in Australia, but they are not the largest multi-national franchises; McDonald's, Hungry Jack's and Kentucky Fried are not among the sample. Nor do the contracts in the sample represent the smallest and newest franchise systems, many of which may not exist in a year's time.²³ The contracts collected for the sample represent several types of industry. An effort was made to obtain more than one contract for each type in order to gain a sense of the variability of contracts within industry types. The contracts analysed represent the following retail or service categories: pizza (two contracts), ice cream (two contracts), retail athletic shoes (two contracts), mobile services (two contracts), mortgage brokers (two contracts), juice bar (one contract), cookies (one contract), bakery (one contract), book-keeping (one contract), business services/coaching agreements (two contracts), popcorn (one contract), coffee shop (one contract), and healthcare services (one contract).

As a legal study of the regulation of the franchise sector, this research contrasts with economic analysis which is the common method of assessing the impact of regulation. Over-emphasis by governments on economic analysis of regulation is misguided because economic measurements cannot be expected to be highly accurate due to the lack of reliable and objective data. This is a particular problem in the franchising sector in Australia, where any economic analysis of the impacts of regulation would lack baseline measurements. Cost-benefit analysis can be applied, but there are

²³ It is, however, the case that a system represented in the sample may no longer be operating.

innumerable variables, for which there is no way to control. As Julia Black points out, at the end of the day the formulation of regulation ultimately boils down to a 'best guess'.²⁴ There can be no certainty, even in strictly economic terms. Reliance on economic measurement also fails to take into account social welfare considerations and normative principles such as the concept that regulation should be broadly democratic and participative. For these reasons the discourse of regulation should include social and legal research as well as economic analysis.

The normative component of this dissertation draws from emerging trends in regulatory theory. It highlights the gaps between what regulatory theory suggests should happen and what is actually happening in the regulation of the franchise sector, and posits some approaches to bridging these gaps. (See Chapter Seven)

This dissertation thus employs a combination of methods to evaluate the role of contract in regulation. The methods are low-intervention, as they involve almost no involvement with human subjects in the franchise operations under study, but instead rely largely on the content of contracts to examine the nature of the relationships. While the small, purposive sample would need to be broadened to provide statistically significant results, benefits of the methods employed here include low cost due to the relative availability of the documents needed and economy of time due to the omission of survey and interview processes.

Perhaps the greatest value in the methods used here lies in the fact that contracts are used by virtually all participants in the sector to lay the ground rules for the franchise relationship. There is therefore a high level of credibility in the use of contracts, as the subjects themselves draft, use and rely upon these documents

Ethical clearances

The Bond University Ethics Committee has advised that ethical clearances are not required. This research involves only the analysis of contracts, which were provided with consent from the franchise systems for this theoretical analysis of the regulation of the franchising relationship. All references to the systems in the study are anonymous and there are no human subjects.

²⁴ Julia Black, comments at her lecture entitled 'Principles Based Regulation', the University of Sydney, 28 March 2007.

1.4 STRUCTURE OF THE DISSERTATION

This dissertation is arranged as eight chapters.

Chapter One provides an introduction to the research. It sets out the objectives and hypothesis, that the regulation of the franchise sector in Australia is effective at achieving two of its stated goals, addressing imbalance of power and uncertainty in the franchise relationship. Chapter One provides a thesis statement, and describes the methodology and terminology used in the dissertation. The introduction also outlines the contributions this research makes to theory and practice. Finally, it summarizes the results and recommendations of this research, as well as its limitations.

Chapter Two explains both the theoretical basis and the structure for this analysis of the regulation of franchising. This chapter describes new conceptions of regulatory activity to which the regulation of franchising might ideally conform. Chapter Two provides an overview of the shift in regulatory theory toward a ‘multi-layered’ approach, and outlines these layers which include public regulation by statute and the courts as well as by private regulation through markets and contract. The structure of this dissertation is organized according to three of these layers of regulation, market, contract and statute; this structure ensures a relatively thorough examination of the regulation of the sector. Chapter Two notes some of the strengths and weaknesses of each layer; it affirms the need for regulatory process to comprehend all these layers as they interact together; and it suggests that there should be no initial preference for one regulatory layer over another. Finally, Chapter Two describes how current theories of regulatory procedure suggest that selection of tools of regulation take place within regulatory process that is democratic and participative. By describing this trend, along with the ‘layers of regulation’, this chapter presents a picture of how regulatory theory has evolved and it advocates a ‘multi-layered’ and process-oriented approach in the regulation of the franchise sector.

Chapter Three provides an overview of the nature of the franchise sector in Australia in order to orient this research in the particular context in which the regulatory process takes place. Chapter Three demonstrates how the market interaction in the franchise sector sets up imbalance of power and uncertainty, the two conditions that legislation is intended to address and that are tested in this dissertation. As this chapter outlines the fundamental nature of the franchise structure; it can also be read as an overview of

regulation of the sector by the parties themselves through the market layer of regulation. The chapter explains some of the social and economic conditions that support franchising, the reasons why franchisors choose this structure for their businesses, and the reasons why franchisees choose to buy franchises. This discussion shows that imbalance of power and uncertainty, particularly for a franchisee, are characteristic of the franchise relationship. Chapter Three considers the lack of balanced, reliable information about the sector. This lack of information is a source of problems, in particular for franchisees, but also for outsiders, such as regulators. It indicates a need for regulatory intervention such as disclosure, but it also means that disclosure, or indeed any regulatory choice for franchising, is made as part of a process that does not conform to current standards of practice in regulatory activity, standards that require good information and measurement. In fact, in the absence of ‘meaningful measurements’ the regulatory process itself reflects and perpetuates imbalance of power and uncertainty in the franchise relationship.

Chapter Four continues the analysis of the layers of franchise regulation by introducing the contract, a self-regulatory, private layer of regulation. The chapter begins with an introduction to the franchise agreement and the role it plays in the franchise relationship. It then considers in some detail two features of the franchise contract that are designed to reduce transaction costs; these are the standard form and relational qualities. Standard form contracts are prevalent across many species of contracting relationships. Relational contracts are also common. This chapter describes the essential attributes of each of these types of contracts. This chapter explains the significant implications of these qualities as they contribute to the imbalance of power and the uncertainty in the relationship. Six synergistic effects of these qualities are also identified and explored; the most significant of these is the high level of discretion to a franchisor that leads to greater power imbalance and greater uncertainty for a franchisee. Chapter Four concludes that, because of the standard form and relational characteristics of the contract, self-regulation of the relationship through contract exacerbates conditions of imbalance of power and uncertainty in the franchise relationship.

Chapter Five continues the analysis of private regulation through the franchise contract by analyzing a sample of nineteen Australian franchise contracts. It presents an analysis of eight contract terms that appear frequently in franchise contracts. The

analysis outlines the purpose of each of these terms and the interests of both a franchisor and a franchisee with respect to each term. Each section provides examples of the different versions of the term from across the sample, unless the length requires that they be provided in an appendix. The analysis shows that these terms reflect and reinforce imbalance of power in the relationship. On balance the sample indicates that contract terms protect the interests of a franchisor over those of franchisees. The sample also indicates that contract terms confer higher levels of discretion upon a franchisor than upon a franchisee, which reflects a power imbalance in favor of a franchisor, and heightens uncertainty for franchisees. There is also a description of the applicable Code provisions with respect to each contract term. Because the results of the sample indicate that imbalance of power and uncertainty persist in the relationship, direct intervention, public regulation through statute, does not achieve two of its stated goals.

Chapter Six focuses on direct intervention. This chapter outlines the three principal components of the statutory regulation of franchising, disclosure, mediation and some substantive provisions, but the focus is mainly on the operation of disclosure. Chapter Six evaluates the effectiveness of the use of disclosure as a regulatory tool. The analysis reveals that disclosure is not as effective as it could be because there is insufficient information about the sector to accurately gauge the risks; because reliable information about franchise systems may not be provided to franchisees; and the information that is provided may not be accessible to and useable by a franchisee. Most importantly, because of the nature of the contract and the relationship, a prospective franchisee is unable to act on the information. Therefore, the principal tool used in the statutory regulation of franchising, disclosure, is not effective. Chapter Six concludes with a discussion of some ways to improve the function of disclosure as the principal regulatory tool.

Chapter Seven concludes the dissertation and is divided into two parts. It begins with a summary of the current nature of the franchising relationship, the franchise contract and contractual obligations of the parties as these private instruments of regulation establish and reinforce the imbalance of power and uncertainty in the relationship. Contract terms indicate the ineffectiveness of regulation in addressing imbalance of power and uncertainty because they continue to manifest, and indeed reinforce these conditions. The imbalance of power at all levels of the franchising

relationship is so pronounced that self-regulatory measures to redress this imbalance and the problems of uncertainty for franchisees cannot be relied upon. Franchisors do not implement such measures because they have a greater interest in protecting their high levels of control and discretion than in including franchisees. Franchisees do not implement them because they lack the information, understanding and the power to do so. The second part of Chapter Seven offers some recommendations. In order to improve the performance of both private and public levels of regulatory governance, Chapter Seven proposes reframing regulation, first by instituting collaboration that includes franchisees in all stages of regulation. Secondly, it recommends a process-oriented approach in order to ensure better measurements and better information about the sector. Finally, this chapter offers some ideas as to how this information can in turn be used by stakeholders and the regulator to identify problems and to select the appropriate regulatory tools to address them.

Chapter Eight is a brief epilogue. It emphasizes the importance of appropriate regulation to enhance competitiveness and highlights some key factors in the reframing of regulation. These include the importance of accurate, reliable information to inform regulatory process as well as to inform participants; the impact of the standard form and relational contract characteristics in the regulation of the franchise relationship; and the deficiencies of disclosure. Chapter Eight also highlights the problems with relying on self-regulatory tools where, as in franchising, half the participants are constrained from effectively playing their roles. Because of the imbalance of power that pervades the relationship, the regulator should take the lead in making the required changes. Taking into consideration all these factors, and because best practice in regulation dictates it, participation and transparent and democratic procedures are needed in the regulation of franchising. Finally, the final chapter reiterates the point that regulation no longer equates simply with direct intervention through legislation, and rules imposed by a regulator. The ‘new learning’ on regulation implies instead a collaborative process at all layers of governance, all stages of interaction, encompassing all participants. Without such a reframing of the regulation of franchising, this dissertation concludes that it is likely that franchising will remain a sector where franchisors are free to abuse their power and from which discouraging stories of failed business will continue to flow.

1.5 LITERATURE REVIEW

Academic studies of franchising worldwide have tended to focus on franchising as a marketing channel and other topics related to management and marketing. There is less research in economics and the law.²⁵ The first book on the economics of franchising anywhere in the world was published in 2005.²⁶ There is no single book devoted to the law of franchising in Australia, though *Franchising Law and Practice* is a looseleaf reference that is updated regularly, providing a useful reference on legal developments in areas of law that affect franchising.²⁷

This dissertation cuts across disciplines of regulation and regulatory theory; franchising as marketing channel; institutional economics and franchising as an organizational form; the economics of franchising; theories of contract, the purpose and enforcement of contracts, efficient contracts, good faith, fairness and default rules analysis; bargaining power; risk; certainty and discretion. A comprehensive review of these many and varied fields of academic literature is not possible, but some introduction to theory is offered where appropriate in the respective chapters of the dissertation.

1.6 TERMINOLOGY

1.6.1 Franchising

Franchising is a way of structuring business relationships that takes many different forms. While it is beyond the scope of this dissertation to survey the many permutations of the franchise form, some basic elements of the structure of franchising are introduced briefly in Chapter Three. Because more than 95 percent of all franchise systems in Australia are business format franchises, in this dissertation the term ‘franchising’ and related terms such as franchise, franchisor and franchisee

²⁵ See Andrew Terry, ‘Franchising, Relational Contracts and the Vibe’ (2005) 33(4), *Australian Business Law Review* 289; Andrew Terry, *Franchising in China*, *Franchising Magazine* (Nov- Dec 2004); and Andrew Terry, *Franchise Network Expansion: Options, Opportunities, Challenges*, Australian Franchise Directory, 2004.

²⁶ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005).

²⁷ This looseleaf is written by Stephen Giles the Chairman of the Franchise Council of Australia (the FCA) with Andrew Terry and other colleagues who are also long-standing members of the FCA. There is less than a handful of volumes on franchising law in the US or the UK, notably Martin Mendelsohn, *Franchising Law* (2nd ed, 2004) and W. Michael Garner, *Franchise Law Desk Book: Selected State Laws, Commentary and Case Annotations* (2nd ed, 2001).

are used in reference to the practice of business format franchising, unless stated otherwise.

The focus of this dissertation and of its regulation through the Franchising Code of Conduct is the interaction between a franchisor and a franchisee. In this dissertation the phrase ‘the franchise relationship’ is used to refer to the relationship between franchisor and a franchisee. In keeping with a convention instituted by the Franchise Law Journal, the terms ‘franchisee’ and ‘franchisor’ are preceded by the article, ‘a’; ‘the’ is generally reserved for reference to a certain franchisee or franchisor.

1.6.2 Regulation

The term, ‘regulation’ has a diversity of meanings. ‘Traditional regulation’ is a term sometimes used to describe a democratically elected legislature making laws which are then enforced through the civil or criminal procedure of the courts.²⁸ Traditionally, the term ‘regulation’ and related terms such as ‘regulatory practice’, ‘regulatory process’, ‘regulatory reform’ and so on, refer to regulation by direct intervention, that is by an outside regulator. This form of regulation is also referred to as ‘statutory’ or ‘legislated’ regulation or intervention, or simply as ‘legislation’ or ‘statute’. It may also be referred to as ‘hard law’; by contrast ‘soft law’ is a term that can be used to refer to any regulatory process other than the traditional process.²⁹

In the academic literature on regulation, the term ‘regulation’ is often used in the broad sense of governance of the relationship, ‘the intentional activity of attempting to control, order, or influence the behaviour of others’.³⁰ As part of a detailed discussion of the definitions of regulation in her paper, *Critical Reflections on Regulation*, Julia Black observes that, ‘conceptual confusion is indicated by definitional chaos’.³¹ Black lists three alternative textbook definitions:

- 1) promulgation of rules by government, usually specialized agency, including enforcement and monitoring;
- 2) any direct state intervention in the economy; or

²⁸ ‘Soft Law and the Consumer Interest’, *European Consumer Law Group*, ECLG/071/2001 - March 2001 <http://ec.europa.eu/consumers/policy/eclg/rep03_en.pdf> at 22 May 2007.

²⁹ Ibid.

³⁰ Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1.

³¹ Id., 11.

3) all mechanisms of social control or influence, affecting all aspects of behaviour, intentional or not.³²

Black notes that, ‘academics use the different meanings with varying amounts of lack of discipline’, sometimes using all three meanings within the same document.³³ In advocating a broader approach to regulation the editors of the recently launched journal, *Regulation and Governance*, describe their mission as one of opening regulatory studies toward governance and moving ‘the boundaries of regulation toward the boundaries of governance.’³⁴ Indications are that it has not yet become widely adopted practice to refer to regulation in as broad a sense as governing. This may be why Hugh Collins uses the term, ‘meta-regulation’ to refer to the collection of forces and actors that contribute to regulatory process.³⁵

Because of the expanding diversity of meanings of regulation, it is becoming increasingly important when speaking of regulation and regulatory activity to describe precisely what form and what meaning of regulation is intended. Qualifiers of the term help to distinguish the intended meaning, as well as to represent different approaches to regulatory activity. Throughout this dissertation the term ‘regulation’ is intended to be construed in the broad sense unless qualifiers are used to narrow the meaning, or the text specifies another meaning, or the context clearly indicates otherwise. ‘Regulatory process’ is used in this dissertation to refer to determining what regulatory action is needed, selecting the appropriate mix of tools and implementing and monitoring that regulatory action. These and other terms connected with regulation and regulatory theory are dealt with in greater detail in Chapter Two.

1.6.3 Contract and agreement

The term ‘contract’ is used in this dissertation to refer to the written document binding a franchisor and franchisee in a franchise relationship in business format franchising. Other documents, including the Franchising Code of Conduct, sometimes employ the

³² Id., 13.

³³ Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1, 13.

³⁴ John Braithwaite, Cary Coglianese and David Levi-Faur, ‘Can regulation and governance make a difference?’ (2007) 1(1) *Regulation & Governance*, 1–7.

³⁵ Hugh Collins, ‘Regulating Contract’ in C. Parker et al (eds), *Regulating Law* (2004) 13.

term, 'agreement' to refer to the contract, and in those cases the original 'agreement' remains in this text. Infrequently in this text the word 'agreement' is used interchangeably with the term 'contract.' This is for purposes of style, convenience and/or consistency with quoted text only. No nuance in meaning is intended.

1.6.4 Efficient and effective

In this dissertation 'efficient' is defined as 'achieving maximum productivity with minimum wasted effort or expense'.³⁶ Adam Smith argued that state and personal efforts to promote social good are ineffectual compared to unbridled market forces. His legacy persists today in the idea that self-interest guides the most efficient use of resources in a nation's economy, and that public welfare is a by-product of an efficient economy. This dissertation takes exception with Smith to the extent that according to broader conceptions of regulation, there is no such thing as 'unbridled market forces'; every private market interaction is itself a form of regulation.

This dissertation, however, is not about efficiency, but rather effectiveness of regulation. Because of the complexity of the concept of efficiency (not only in economic terms) and the concomitant difficulties in defining and measuring efficiency, this dissertation evaluates only whether the regulation is 'effective', in the sense of 'successful in producing a desired or intended result.'³⁷ In evaluating effectiveness in achieving intended results, the results are the stated objectives of regulation of franchising in Australia. Specifically, the question this analysis addresses is whether the Franchising Code of Conduct achieves two of its stated objectives, addressing the imbalance of power between franchisors and franchisees and increasing the level of certainty for all participants. This dissertation does not engage in evaluating whether the goals of regulation are the right ones, such as whether there should be more balance or certainty in the franchise relationship. More research is needed about the nature of the franchise relationship to address this question as part of a reframed regulatory process. These are the goals; this

³⁶ *The Oxford Dictionary of English* (2nd ed, 2005).

³⁷ Synonyms are effective and efficacious. *The Oxford Dictionary of English* (2nd ed, 2005). Efficiency is of course related to effectiveness in that the assessment of effectiveness of statutory regulation does help to assess its efficiency. In order for regulation to be efficient, it must be effective; it must produce the desired result(s). If it does not, then regulation is not only ineffective, because it is not 'successful in producing a desired or intended result.' but it is also inefficient because it does not achieve productivity.

dissertation for the most part confines itself to the question of whether they have been achieved.

1.6.5 Imbalance of power, discretion, and uncertainty

This dissertation assesses the effectiveness of statutory regulation in achieving two of the stated goals of regulatory intervention, overcoming imbalance of power and uncertainty. Power is defined as, ‘Strength in arranging the terms of one's dealing with other firms or people.’³⁸ Imbalance is defined as ‘lack of proportion or relation between corresponding things.’³⁹ Imbalance of power is, then, a lack of proportion or relation between parties’ strength in arranging the terms of dealing that,

‘depends on the losses failure to agree is likely to cause to the various parties to a negotiation. In the absence of agreement, each party has a fall-back position: the less uncomfortable this is, and the longer any party can afford to stay in it, the stronger is their bargaining power. A party with a very uncomfortable fall-back position and an urgent need for an agreement has very little bargaining power. Bargaining power is increased by unity, financial reserves, and a reputation for toughness, and is decreased by division, shaky finances, and a reputation for being willing to compromise.’⁴⁰

Discretion is defined as ‘the power or right to decide or act according to one's own judgment; freedom of judgment or choice.’⁴¹ A franchisor’s discretion to act equates to a ‘right of action’.⁴² The disadvantages of discretion are that it usually facilitates action on improper considerations, and permits the substitution of subjective, personal standards for accepted or agreed upon ones. Hawkins writes that ‘discretion is power, with all its corrupting implications’.⁴³

This dissertation argues that not only is there imbalance of power between parties to a franchise contract at the time of entering the relationship, contract formation, but also throughout the performance of the contract. The balance of power at formation

³⁸ John Black, *A Dictionary of Economics*. (2002). *Oxford Reference Online*. Oxford University Press, <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e2399>> 20 November 2006.

³⁹ *The Oxford Dictionary of English* (2nd ed, 2005).

⁴⁰ John Black, *A Dictionary of Economics*. Oxford University Press, 2002. *Oxford Reference Online*. Oxford University Press. Bond University. 20 November 2006 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e185>>.

⁴¹ *Random House Unabridged Dictionary*, (2006).

⁴² William L. Killion, ‘Putting Critical Decision-Making Where It Belongs: Scouring the Franchise Agreement for the “D” Word’ (2005) 24 *Franchise Law Journal* 228.

⁴³ K. Hawkins, *The Uses of Discretion* (1992) 4.

influences the balance throughout because it sets the tone of the relationship, and also because the contract formalizes the levels of discretion accorded to the parties to deal with uncertainty throughout performance. The flexibility that is built into the contract to accommodate the uncertainty of the longer term mainly accrues to the drafter. This means that there is imbalance of power not only in terms of bargaining power at the time of contract formation, but also an imbalance of power throughout the performance of the contract.

A franchisor has the greater power throughout the performance of the contract, including the power to deflect uncertainty, and with it risk, to a franchisee. Thus, in a contract that is both standard form and relational power and certainty are linked; the link is discretion. The party that has discretion has the power and the certainty that it can make choices to benefit itself. The party that gives discretion, a franchisee, bears the uncertainty and increased risk.

The following economic definition of uncertainty underscores the link between risk and uncertainty:

‘A consciousness of lack of knowledge about present facts or future possibilities. ...Some writers distinguish between risk and uncertainty...Many authors, however, simply use risk and uncertainty interchangeably.’⁴⁴

Another definition of uncertainty states that it,

‘arises when decisions have to be made about the future where it is not possible to assign probabilities to the various outcomes. Often used as a synonym for risk.’ (sic) Risk is defined as ‘the possibility of large price or rate movements in assets or liabilities, usually computed using probabilities. Most commentators and market practitioners associate risk with adverse, or the downside, effects of price or rate movements’⁴⁵

Uncertainty will be used in this dissertation to refer to the inability of a franchisee to predict, and, is closely related to flexibility in the contract, grants of discretion to a franchisor, and risk to a franchisee.

⁴⁴ John Black, *Dictionary of Economics*. Oxford University Press, 2002. *Oxford Reference Online*. Oxford University Press. Bond University. 20 November 2006
<<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e3223>.

⁴⁵ *The Handbook of International Financial Terms*. Peter Moles and Nicholas Terry. Oxford University Press 1997. *Oxford Reference Online*. Oxford University Press. Bond University. 20 November 2006
<<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t181.e8049>.

1.7 RESEARCH CONTRIBUTION

1.7.1 Contribution to research

Industry groups and politicians alike call for more empirical research.⁴⁶ No study of the terms of franchise contracts has been conducted in Australia, and only a handful of studies have appeared in the US literature on contractual provisions, mostly from economics and marketing perspectives.⁴⁷ A 1990 article by Gillian Hadfield considering the relational aspects of franchise contracts is still quoted today among academics in Australia.⁴⁸ This dissertation adds to the literature; it is the only available research at this time that:

- Provides new empirical information about the contents of franchise agreements;
- Constructs and applies a model for evaluating regulation of franchising based on a ‘multi-layered’ governance approach that considers both private and public governance;
- In the context of changing approaches to regulation, describes the role of contract as both a tool and an object of regulation of the franchise sector;
- Identifies the synergistic effects of standard form and relational qualities of franchise contracts;
- Includes a comprehensive content analysis of several terms in franchise contracts as they reflect the interests of the parties, as they are subject to regulatory requirements, and as they reflect the attainment of regulatory goals;

⁴⁶ The IFA (3.4.1.6) and Mehta and Pelton, ‘Limitations of Existing Theories: A Need for “A General Theory of Franchise Relationships”’ (Paper presented at the 14th Annual International Society of Franchising, San Diego, February 19-20, 2000).

⁴⁷ See, for example, Janet Bercovitz, ‘An Analysis of the Contract Provisions in Business Format Franchise Agreements’, *International Society for New Institutional Economics* (1999) accessed at <<http://www.isnie.org/ISNIE00/Papers/Bercovitz.pdf>> 8 December 2004; Antony W Dnes., ‘A Case-Study Analysis of Franchise Contracts’ (June, 1993) *XXII Journal of Legal Studies* 367; and Francine Lafontaine and Margaret E. Slade, ‘Incentive Contracting and the Franchise Decision’ in Chatterjee, Kalyan and Samuelson (eds) *Game Theory and Business Applications* (2001) 134.

⁴⁸ Gillian Hadfield, ‘Problematic Relations: Franchising and the Law of Incomplete Contracts’ (1990) *42 Stanford Law Review* 927.

- Evaluates whether contract terms reflect the stated goals of regulatory intervention;
- Analyses the effectiveness of disclosure as regulatory strategy for franchise contracts and assesses the suitability of disclosure as the principal tool in regulating the franchise sector; and
- Applies a simple prescription for best practice in regulating franchising, utilising three ‘core elements’ as follows:
 - better information about franchising;
 - alternative means of regulating the sector, based on results of its analysis, regulatory theory and comparisons with regulatory regimes in other jurisdictions; and
 - implementation of collaborative process in the regulation of franchising.

1.7.2 Contribution to theory

With respect to theories of contract the dissertation reinforces the importance of contract. It refutes the idea that contract is of secondary importance, and it does so in a business sector where many ancillary agreements can and do support the relationship. Instead, contract plays major roles as a tool for regulating the relationship by the parties themselves and as an object of public regulation in the legal recognition, interpretation, regulation and enforcement of the relationship.

It has not been the aim here to prove or disprove any theoretical argument about the role of contract in regulation, but rather to apply a practical approach in exploring the role of contract in the regulation of the franchise relationship. Therefore, while the debate about the underlying values of contract law is beyond its scope, this dissertation adds to the body of evidence about the roles played by contract in commercial relationships.

With respect to regulatory theory the dissertation situates its analysis of the the franchise contract in the context of the ‘new learning’ on regulation. In this context contract serves as but one component in a ‘multi-layered system of governance’, through which states achieve regulatory goals of social justice, social cohesion,

augmenting wealth or other goals.⁴⁹ At the same time as the scope of regulatory activity is defined more broadly, with increasing trade liberalisation there is an increasing emphasis on the law of particular market sectors. As Collins notes, ‘In order to achieve adequate contextual understanding of transactions, the regulatory and adjudicatory bodies will become established on the basis of market sectors rather than political demarcations.’⁵⁰ This dissertation comports with this pattern as it considers regulation in the context of a particular market sector.

Contract as regulation is also addressed in this dissertation. This dissertation is the first of its kind to examine the synergistic impacts of the standard form and relational qualities of the franchise contract. In the past commentators have undertaken separate discussions of standard form and relational contracting, some with respect to franchising in particular.⁵¹ In franchising, the nature of the contract prevents its optimal function as a reflection of the true intentions of the parties, and it impedes the function of disclosure, the principal tool used in statutory intervention. The author is not aware of any other scholarship with respect to the *interaction* of these qualities, even though such interaction would occur not only in franchising, but in many types of contracting scenarios.

Finally, this dissertation tests the idea that contract as a private means of governance is preferable to regulatory intervention. It suggests that in practice over-reliance on regulation by contract can be counter-productive. There is, in fact, a reliance and confidence in self-regulation that is misplaced, given the characteristics of the franchise contract and the context of the franchise relationship.

1.7.3 Contribution to practice

This analysis of content and context of specific contract terms offers an expansive view of the nature of the contract, as it reflects the needs of the parties and responds to

⁴⁹ For a discussion of multi-layered governance see Hugh Collins, ‘Regulating Contract’ in C. Parker et al (eds), *Regulating Law* (2004). Multi-layered governance and the new learning on regulation will be discussed in greater detail in Chapter Two.

⁵⁰ Hugh Collins, *Regulating Contracts* (1999) 360.

⁵¹ On relational contracting see V.L. Taylor, ‘Contracts with the Lot: Franchises, Good Faith and Contract Regulation’ (1997) *New Zealand Law Review* 459; I. MacNeil ‘Relational Contract Theory: Challenges and Queries (2000) *NWULR* 877; David Goddard, ‘Long-Term Contracts: A Law and Economics Perspective’ (1997) *New Zealand Law Review* 423 on relational contracting and James Jordan and Judith Gitterman, ‘Franchise Agreements: Contract of Adhesion?’ (1996) 16 *Franchise Law Journal* 1 on the standard form aspects of franchise contracts.

regulation. Such information can be useful to the parties themselves and to the solicitors who represent them as well as to courts in interpreting and legislators and their delegated bodies in regulating. Further, the analysis informs a discussion of possible alternative approaches to bring the 'layers of governance' into more harmonized and effective operation. It recommends, however, that the proper locus of ongoing regulatory activity is a democratic, participative and transparent process.

Analysis of the statutory regulation of the franchise sector in Australia is relevant not only in Australia, but in many other countries, as well as for harmonization of regulation across jurisdictions. The Australian experience with the regulation of franchising is instructive for several reasons. First, regulatory practice in Australia is of a generally high standard,⁵² second, the fact that several different approaches have been tested means Australia has greater depth of experience than many countries; and third, as Australia has a relatively high number of franchises per capita,⁵³ its regulation is tested in a significant and growing sector of the economy.⁵⁴ While this is Australian-based research, other jurisdictions appear to exhibit similar conditions; in these jurisdictions as well, it may be necessary to re-evaluate the use of disclosure. In addition to the usual advantages to consistency in regulation across jurisdictions, the importance of uniformity in franchising is a further, sector-specific reason why consistent regulation is particularly desirable.

Franchising in Australia offers opportunities for many people who have and will continue to invest their money, time and aspirations into franchising. There are indeed healthy franchise systems, which offer excellent opportunities to franchisees. There are franchisors whose business practices are of the highest standards and beneficial to their franchisees. There are also franchisors that persist in taking unfair advantage of franchisees. Regulation should be tailored as precisely as possible to encourage the former while at the same time curtailing the opportunistic activities of the latter. If the franchise sector is to evolve in a salutary fashion, if it is to deserve the image that it goes to some lengths to maintain, it cannot afford to believe its own

⁵² Telephone conversation with Paul Bek (Office of Regulation Review, Canberra), 19 October 2004.

⁵³ The *Franchising Australia 2002 Survey* reports that Australia has three times the number of systems per capita than the US. Frazer and Weaven, *Franchising Australia 2002 Survey*, Griffith University and the Franchise Council of Australia Ltd. (2002)

⁵⁴ Though the US may have a wider and more varied record of franchise regulation, both at the state and federal levels, the complexity of legislation in the US at state and federal levels limits its role as a model regulatory environment.

marketing slogans when they become insupportable by the facts. The future hopes for the success of the franchise sector depend on its ability to take an accurate account of itself and to look beyond what it wants to see. This research indicates a need for a change in attitudes and approaches in the sector, in particular for a reframing of regulation. Healthy systems would not be threatened by this shift and the sector as a whole could benefit.⁵⁵

1.8 RESULTS AND RECOMMENDATIONS

This dissertation considers whether the regulation of franchising is effective in meeting two of the stated goals of legislated intervention. Theories of regulation have evolved beyond direct intervention; therefore, this dissertation adopts the ‘multi-layered’ approach, focussing particularly on contract and legislation. It concludes that in the market interaction a franchisor is more experienced in franchising than a franchisee. A franchisee often fails to understand the nature of the relationship, and may be getting into a franchise business for the wrong reasons, with major misconceptions. A franchisee is not an effective and informed participant, but rather takes on the qualities of a consumer in a market transaction that involves a standard form contracting relationship. Market regulation is therefore not effective because of lack of information, power imbalance, and franchisee inexperience. The market interaction is in fact characterized by imbalance of power, as well as high levels of uncertainty for a franchisee.

Second, in the regulation of the franchise relationship by means of contract, a franchisee is also not an equal and active participant. The synergistic effects of the standard form and relational qualities of the franchise contract lead to the erosion of bargained-for-exchange, increased imbalance of power and increased uncertainty for a franchisee. A franchisee is not a party to the drafting of the contract, is not able to negotiate the contract, and cannot participate in determining how the contract is to be performed. Self-regulation through the contract thus reinforces the imbalance of power and uncertainty of the arrangement for a franchisee.

⁵⁵ Jim’s Services, for example, has already simplified its contract and made changes that reflect some of these principles.

Third, in regulation of the franchise relationship by statutory intervention a franchisee is once again constrained from playing its role. A franchisee is responsible for carrying out the function of the principal tool used in the regulation of franchising, disclosure. A franchisee cannot do this effectively because it is not ensured receipt of reliable information in a form and at a time when it can best use the information. Also, disclosure as a regulatory strategy is inconsistent with standard form and relational characteristics of the contract and for this reason may be less effective than with other types of contract. Finally, a franchisee does not play its proper role in regulatory process generally. While franchisors are well-represented to the regulator, franchisees play a negligible role; they are not equal participants in the process of regulatory intervention.

While market and contract as private means of governance are, in theory, considered preferable to regulatory intervention, self-regulation cannot be relied upon in franchising. Direct intervention, too, relies on a low-intervention form of regulation that is self-regulatory in that it puts the onus on the parties to effectively implement. Thus, every layer of regulation of franchising emphasizes self-regulatory layers that are not optimally effective because of the pervasive marginalization of a franchisee.

The sample of contract terms shows that the stated objectives of the Franchising Code of Conduct, certainty and balance of power, are not reflected in the contractual terms, principally because of the high levels of flexibility and discretion accorded to a franchisor. The dissertation therefore indicates that the self-regulatory layers relied upon in the regulation of the franchise sector are ineffective at achieving the goals of regulation. The dissertation turns its attention towards a possible solution.

This dissertation makes the following recommendations with respect to the regulation of franchising in Australia in order to better achieve the stated objectives of addressing the imbalance of power and increasing certainty for participants in the sector:

- Ensure that there is accurate and reliable information about the sector to provide a basis for identifying problems, setting goals, selecting tools and evaluating the performance of the sector and its regulation
- Revise the approach to self-regulation. The current heavy reliance on self-regulatory layers fails not because self-regulation is inherently flawed, but

because reflexive processes cannot function correctly without the full participation of all stakeholders. In franchising they fail due to the marginalization of franchisees. This does not mean that self-regulatory layers should be abandoned. First, they cannot be abandoned, as parties continue to regulate themselves through market and contract layers. Secondly, they should not be abandoned because of the greater contextual understanding of the participants themselves of the complexities of the arrangement. Regulatory activity requires particularized knowledge and experience that underscores the importance of self-regulatory layers. Instead, as current processes are insufficiently participative and democratic because of inadequate representation of franchisees, it is recommended to ensure full franchisee participation in regulatory processes. This dissertation has demonstrated that a franchisee is marginalized in every aspect of the regulatory process, both private and public, while a franchisor is consistently in control of, better informed, and/or better represented in all aspects of regulation dominates the governance of the relationship. If the marginalization of a franchisee in the regulatory process can be addressed, self-regulation can be expected to function more effectively.

- Implement collaborative process to address the limitations in the current use of tools as follows:
 - A participative process should be used to address the problems in the current disclosure requirements, specifically to:
 - ensure accurate reliable information is provided to franchisees;
 - ensure that information is provided in a form that a franchisee can use, at a time and place that enables its optimum use;
 - address inconsistency with statutory provisions prohibiting misleading or deceptive conduct; and
 - emphasize the objective of empowering franchisees to make decisions rather than the objective of enabling franchisors to reduce their risk of liability.
 - A participative process should be used also to explore:

- the potential application of regulatory tools and strategies in addition to disclosure;
- tools and strategies to address the problems that arise in the context of standard form and relational contract characteristics;
- with respect to particular contract terms, strategies for addressing imbalance of power and certainty that may not unduly compromise and indeed may enhance the benefits of the business structure.

To summarize, in order for regulation of franchising to be more effective, revision of the current regulatory approach should involve 1) enhanced involvement of parties as participants in self-regulation and collaborative processes 2) improvements to and increased support for the disclosure strategy already in place, and 3) expansion of the range of tools and regulatory strategies that could be employed in the sector in addition to disclosure.

1.9 LIMITATIONS AND IMPLICATIONS FOR FUTURE RESEARCH

This dissertation is limited to an analysis of the regulation of the franchise sector in Australia, in particular through the lens of contract. It is subject to limitations.

- The research, while it has applications for other jurisdictions, is particular to Australia.
- With respect to regulatory process, this research assesses the role of contract in meeting regulatory goals, but it does not evaluate or analyse these goals. The problems in franchising have been introduced but not analysed.
- This research offers a review of regulatory process in the franchising sector in Australia, but disclosure is the focus of this analysis. The two other principal tools in the regulation of franchising, mandatory dispute resolution procedures and the limited substantive regulation provided for in the Franchising Code of Conduct,⁵⁶ are not dealt with in detail in this dissertation.

⁵⁶ These substantive regulations concern transfer and termination procedures, a cooling-off period, and prohibitions against general indemnity of franchisor and against franchisor prevention of franchisee association.

- The analysis of the standard form and relational characteristics of contract focuses on three synergistic effects of these characteristics, and introduces but does not explore some other important implications, such as their effect on the role of trust in the relationship.
- This dissertation does not engage in the ongoing debate over the role of contract; many aspects of the role of contract remain to be explored. While franchising is typically characterized by a series of interrelated contracts governing a wide range of dynamic issues, what is not sufficiently understood is how these agreements function together over time and how they reflect and affect both the relationships of the parties involved and the business and regulatory environments in which they operate. What we lack, it seems, is an understanding of the ecology of contract in franchising.⁵⁷
- The layers of regulatory governance that provide structure to this dissertation include private layers of market and contract as well as the public layer of legislation. The court interpretation of the contractual relationship is also considered a form of regulation, public or quasi-public. While this layer was introduced in Chapter Two, in the interests of containing the scope of this dissertation, it does not contain an analysis of this aspect of regulation. Court interpretation of contractual relationships is informed by cues provided by the context of the relationship and by legislation, which are the focus of this dissertation.

⁵⁷ In practical terms, these may be more important than the franchise agreement. The franchise agreement fixes the foundation; the Operations Manual is how the franchisor controls the relationship. This study concludes that the intrinsic relationship cannot be excluded from the consideration of the terms. As the extent of the intrinsic relationship is generally contained in these ancillary documents, more research is needed in this area.

This research has a number of implications for future research:

- More analysis is needed of the effectiveness and efficiency of regulation, for example cost-benefit analysis of regulatory measures. Most pressing is the need for ‘meaningful measurements’,⁵⁸ including baseline measurements to track the effects of regulation. These would include, for example, better measurements of the experience and levels of satisfaction of participants, more complete information on the nature and disposition of dispute processes, and reliable economic indicators of the health of the sector over time.
- There is a need for more research on franchising as an organizational form, how it comprises elements of employment, agency, partnership, and how it compares with licensing and distributorship. Work is currently being done also on the property rights implicated by these relationships. Also, a franchisee’s role as investor and consumer should be further examined.
- With respect to the agreement, more research is also needed to determine the role played by ancillary arrangements, for example how far these parallel arrangements may be effective to vary or supplement the principal agreement.
- There is a need for further analysis of tools available for regulating franchising and how they can be employed. A comparative framework of the tools used in various jurisdictions would be useful for the ongoing analysis of these tools and their effectiveness.
- With respect to regulatory tools, it would also be interesting to consider further the role played in the regulatory scheme by court interpretation of the franchise contract.
- More work remains to be done on the roles of the contract in franchising on a theoretical level, for example, on how the balance is struck between promoting efficiency as opposed to fairness in the contracting and regulatory processes. A balance must continually be struck between franchisor control in the

⁵⁸ See Malcolm Sparrow ‘PLENARY 4: Effective Regulation’ (Paper presented at the John F. Kennedy School of Government, Harvard University at 25th annual conference of the International Organisation of Securities Commissions (IOSCO) Sydney, 14-19 May 2000)
<[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/\\$file/plen_4_sparrow.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/$file/plen_4_sparrow.pdf)> at 14 September 2006.

interests of trademark and brand maintenance and the interests of individual franchisees which are often sacrificed for the sake of that control.

- The role of industry associations also should be explored.

This dissertation deals only with the common law of contract in Australia and the United States. It makes no attempt to explore the law of franchising in civil law systems or indeed in any other legal system, though some parallels may fairly be drawn with other common law systems. As the author has not had the benefit of practical experience in franchise law, this dissertation is theoretical, though it is hoped that it will have practical application. The law is stated as at 1 April 2007.

Chapter Two

The Regulation of Franchising and the ‘New Learning’ on Regulation

‘Self-regulation, a venerable tradition in UK consumer law, is now the *plat du jour* in studies of regulation and a central focus in the new learning.’⁵⁹

‘[R]esponsive regulation needs to respect the ‘paramount values’ of democracy, participation, and citizenship...[G]overnance arrangements in both economic and social spheres should be decided through careful consideration of the various interests and conditions obtaining in different settings, following full public and local debate about policy goals and the best means to their achievement.’⁶⁰

2.0 INTRODUCTION

There is a public lack of confidence in regulation, but a change in attitude is warranted for two reasons. One is the potential benefit of effective regulation, which is discussed briefly in this chapter, the second is the changing conception of what regulation is, and this is the main focus of this chapter.

This chapter explains the development of theoretical approaches to regulation that have evolved from interest-based to process-based to systems-based approaches. These systems approaches encompass a wide range of organizational structures and inputs, and so represent a departure from traditional conceptions of regulation. Systems approaches are more inclusive and rely more heavily on principles of self-regulation, reflexion and responsiveness. They stress the importance of process that is both participative and democratic. Along with this wide range of organizational structures and inputs has come an expanded conception of the range of regulatory layers, both public and private, in a ‘multi-layered’ system of governance, and here too, there is a departure from traditional distinctions between private and public regulation.⁶¹

⁵⁹ Iain Ramsay, ‘Regulatory Capitalism and the ‘New Learning’ in Regulation’, 28 *Sydney Law Review* 9 (2006).

⁶⁰ Peter Vincent-Jones, ‘Contractual Governance: Institutional and Organisational Analysis’ (2000) 20 *Oxford Journal Legal Studies* 317, 351.

⁶¹ Hugh Collins, *Regulating Contracts* (1999) 358.

Chapter Two introduces the Franchising Code of Conduct and places it in the context of the development of theories of regulation. It first traces briefly the development of statutory regulation of franchising in Australia and the studies, reviews and revisions of this regulation that have led to the current regulatory regime.

The concept of a ‘multi-layered system of governance’ provides the structure for the analysis of the regulation of franchising. Throughout this dissertation the function of the Franchising Code of Conduct will be evaluated in the context of a multi-layered system of governance that encompasses regulation not only by statute, such as the Code itself, but also by other public or quasi-public layers of regulation, such as the courts, as well as private layers of regulation, such as market and contract. Subsequent chapters will build on this theoretical framework. Chapter Three represents regulation by market forces; Chapters Four and Five, regulation by means of contract; and Chapter Six focuses on regulation by direct intervention.

Because of the important role it plays in the franchise relationship, particular attention is given in this research to the franchise contract. This chapter outlines the role of the law of contract as a component of regulatory process. The chapter also examines Hugh Collins’ preference for the use of contract as a regulatory tool and suggests that such a preference is only valid to the extent that it, or any other regulatory measure, is selected as part of a participatory regulatory process.

The final section of this chapter outlines some models of best practice in regulating and introduces Malcolm Sparrow’s model which is adopted in this dissertation as a possible model for the process of regulation of franchising in Australia. Such a process of regulation encompasses a diverse range of participants and a wide choice of tools to regulate; the trend is toward a conception of regulation the capacity of which is greatly increased because it can involve virtually any form of governance. In an era where ‘regulatory studies have emerged at the cutting edge of paradigmatic change in the social sciences’,⁶² there is hope that public confidence in regulation can be re-established.

2.1 PUBLIC MISTRUST OF REGULATION

In 2001 the US Office of Management and Budget estimated the cost of federal

⁶² John Braithwaite, Cary Coglianese and David Levi-Faur, ‘Can regulation and governance make a difference?’ (2007) *Regulation & Governance* 1 (1), 1–7.

regulations at \$380 billion per annum, or about ten percent of America's gross domestic product (more than half the output of the US manufacturing sector).⁶³ The Australian Chamber of Commerce and Industry (the ACCI) estimates that regulation costs the economy about ten percent of gross domestic product, or \$86 billion. These figures are probably underestimates, as many of the costs of regulation are hidden in the prices of products and services, reduced innovation, and lost opportunities.

The public mistrust of regulation is related to two misconceptions. The first is that regulation 'does more harm than good'. A 2004 World Bank study found that heavier regulation is generally associated with higher unemployment and corruption and lower productivity and investment.⁶⁴ Inefficient regulation has the potential to erode confidence, to impede the growth of successful business, and to retard needed change in the sector or in individual industries within it. Further, it may limit the expansion of consumer choice, reduce entrepreneurial initiative, and often advantages some unfairly at the expense of others.⁶⁵ The costs of bad regulation exceed benefits and because many regulatory costs fall disproportionately on small businesses,⁶⁶ if regulation is ineffective, small business feels it first. The ACCI reports that about 75 percent of businesses are concerned about the costs of regulation.⁶⁷

⁶³ James L. Gattuso, *Reforming Regulation to Keep America's Small Businesses Competitive* (2001) The Heritage Foundation
<http://www.heritage.org/Research/Regulation/tst052104a.cfm#_ftn2#_ftn2> at May 21 2004.

⁶⁴ World Bank, International Finance Corporation, *Doing Business in Australia in 2004: Understanding Regulation* (2003) p. xiv. The Pew Research Center released a report, also in 2004, showing that 53 percent of Americans agreed that, 'Government regulation of business usually does more harm than good.' That is nearly the same level as in 1999 (55 percent), though still well below levels in the mid-1990s when anti-government sentiment soared. A similar pattern is evident in other values relating to government. During the early and mid-1990s, as many as seven-in-ten agreed that "when something is run by the government, it is usually inefficient and wasteful". The percentage holding the view declined in the latter part of the decade, and decreased even further in the past few years. In the current survey, 57 percent agree that something run by the government is likely to be inefficient and wasteful. The Pew Research Center, *The 2004 Political Landscape: Business, Government, Regulation and Labour* (2004) The Pew Research Center [7] <<http://people-press.org/reports/display.php3?PageID=756>> at 18 June 2005.

⁶⁵ Sveinbjörn Blöndal and Dirk Pilät, *The Economic Benefits of Regulatory Reform* (1997) Organization for Economic Co-operation and Development [29]
<<http://www.oecd.org/dataoecd/22/21/2733617.pdf>> at 29 December 2005.

⁶⁶ A Crain and Hopkins study found that firms employing fewer than 20 people faced regulatory costs of almost \$7,000 per employee, compared to an average of \$4,700 for all firms, not including indirect burdens and secondary costs. See W. Mark Crain and Thomas D. Hopkins, 'The Impact of Regulatory Costs on Small Firms: A Report for the Office of Advocacy, US Small Business Administration,' RFP No. SBAHW-00-R-0027.

⁶⁷ Peter Switzer, 'Glowing reports on regulation ignore the ugly truth', *The Australian*, 28 November 2006.

While regulation that is poorly conceived and badly implemented can be harmful to economic health, however, appropriate regulation can enhance economic growth and competitiveness.⁶⁸ Properly targeted and implemented regulatory measures can reduce costs of unfair practices and failed businesses, reinvigorate consumer confidence and stimulate investment. In an age of increasing international trade an effective regulatory scheme can attract foreign investment and facilitate local expansion overseas.⁶⁹

Some experts advise businesses to seek out areas with progressive regulation in terms of concern with social problems, and to set internal goals that meet or exceed regulatory standards because this ultimately leads to advantage as other jurisdictions modify their regulations to follow suit.⁷⁰ If they are right, then the franchising sector in Australia will want to promote an effective regulatory scheme as a competitive advantage for the sector.

Public mistrust of regulation persists because of the lack of definitive proof of the benefits of regulation. Experts cannot agree on what regulation is, nor have they agreed upon a methodology for evaluating regulation. Until such determinations can be made, regulation remains a ‘best-guess’ exercise. It is inappropriate and imprudent that such a complex and value-laden activity should be the exclusive province of economists.

The second misconception that leads to mistrust of regulation is the narrow view of what regulation is. The public still thinks in terms of regulation as opposed to ‘no regulation’. A broader definition of regulation, however, requires recognition that there is actually no such thing as ‘no regulation’. There may be different conceptions

⁶⁸ Sveinbjörn Blöndal and Dirk Pilät, *The Economic Benefits of Regulatory Reform* (1997) Organization for Economic Co-operation and Development [30] <<http://www.oecd.org/dataoecd/22/21/2733617.pdf>> at 29 December 2005. On the distinction between the regulation of standards and the regulation of competition, see Porter *The Competitive Advantage of Nations* (1990). The topic is also discussed in Braithwaite, *Responsive Regulation for Australia*, Ch 6 in Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993).

⁶⁹ See OECD website on regulatory reform at <<http://www.oecd.org>>. According to 2004 Franchise Council of Australia Survey figures, 55.3 percent of Australian franchisors intend to expand internationally. The regulatory program in Australia can pave the way for this expansion, by setting the standard for others countries to follow, by encouraging uniformity in regulation that can improve the conditions for international operations of the industry, and by increasing the likelihood that foreign regulatory requirements will be consistent with those in Australia, thus making it easier for Australian franchisors to make the transition to foreign markets.

⁷⁰ Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993) 88, citing Michael E. Porter, *The Competitive Advantage of Nations* (1990) 586, 588.

and means of regulation, but, in the broad sense, regulation is inescapable; we are ‘enmeshed within an elaborate web of regulatory requirements’.⁷¹ If regulation cannot be eliminated, the question, then, is not whether there will be regulation, but rather what forms it should take.

2.2 NEW THEORIES OF REGULATION: TOWARDS SYSTEMS-BASED APPROACHES

The evolution of regulatory theory tracks the developments leading to the current, expanded view of regulation, and provides some useful insights about how current approaches to regulation have borrowed from the biological and social sciences in an evolution towards systems-based approaches.

Early theories of regulation focus on the nature of the interests involved and on the question of whose interests prevail in the regulatory process. The ‘public interest’ theory,⁷² for example, considers regulation as a state response to abuses in a regulated sector.⁷³ Stemming from the public choice theory of law and economics, it focuses on the implementation of law as the result of political process.⁷⁴ Public interest regulation requires a disinterested, efficient, expert and competent regulator. Problems with this approach stem from the clash of values in determining what is in the ‘public interest’, as well as problems due to lack of funding and training of regulatory administrators.⁷⁵

‘Private interest’⁷⁶ theory de-emphasizes ideology and policy goals. Instead, it regards regulation as a reflection of the private interests that influence regulatory process.⁷⁷ The purpose of regulation, according to this theory, is to serve the special interests of

⁷¹ Robert Baldwin, Colin Scott, and Christopher Hood (eds), *A Reader on Regulation* (1998) 1.

⁷² Also known as public choice or normative-positivist theory.

⁷³ Johan Den Hertog, ‘General Theories of Regulation’ in Bouckaert et al, *Encyclopedia of Law and Economics, vol II: The Regulation of Contracts* (2000).

⁷⁴ Nicholas Mercuro and Steven G. Medema, *Economics and the Law* (1997) 84.

⁷⁵ Baldwin and Cave suggest that the public interest vision may really only be viable in the early stages of the regulatory ‘life-cycle’. Life cycle theory is introduced below. For more information see Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 20.

⁷⁶ Also known as Chicago or economic-libertarian theory.

Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 23.

the individuals who shape it.⁷⁸ Interest group theory, like private interest theory, views regulation as the result of the inputs of interested parties. It encompasses competing interests and considers the relationships among private interests as well as between them and the state. Regulatory process is a negotiation of interests, and the resulting regulation represents a compromise of both public goals and private interests. Competing groups engage in a struggle for power in which the prevailing groups formulate regulations that may exclude other legitimate interests.⁷⁹

‘Capture’ and ‘life cycle’ theories focus less on who regulates and more on the process of regulating. ‘Capture’ theory concerns itself with economic and political influence over the regulator, where industry may take advantage of being ‘regulated’. For example, an industry or sector can use regulation to protect itself from competition or to insulate itself from further government scrutiny. In the franchise context this might, for example, take the form of the Franchise Council of Australia (the FCA) influencing the Australian Competition and Consumer Commission (the ACCC) to help moderate and harmonize state fair trading and retail tenancy legislation. While cooperation between the regulated industry and the regulator may result in legislation that carries greater force of buy-in, capture theory highlights the risk of the regulator becoming subject to the influence of the regulated interest.

The ‘life-cycle’ theory of regulation, as conceived by Bernstein, identifies four stages in the life cycle of a regulator; these stages are gestation, youth, maturity, and old age.⁸⁰ Each stage is characterized by the role of the regulator, but also by the changing nature of legislation and enforcement, and third party influence. This theory views the confluence of regulated and regulator interests as a natural step in the institutional development of the regulator. At some stage the regulator may even take

⁷⁸ Roman Tomasic (ed), *Business Regulation in Australia* (1984) 16-17; See also Johan Den Hertog, , ‘General Theories of Regulation’ in Bouckaert et al, *Encyclopedia of Law and Economics, vol II: The Regulation of Contracts* (2000) 9-14. Den Hertog refers to this theory as public choice theory.

⁷⁹ Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 21.

⁸⁰ David Levi-Faur, *Theories of Regulation* (1999) School of Political Science, University of Haifa, Israel <<http://poli.haifa.ac.il/~levi/regutheories.htm>> at 13 April 2004. See Levi interpretation of Bernstein, (1955) at 74-95. Levi lists criticisms of this model as follows: (1) It lacks empirical support, but anecdotal observations suggest that it has legitimacy (2) It fails to explain the problems involved in the legal process. (3)The distinctions between stages are unclear, but this can be attributed to the gradual process of the stages where one does overlap with another (4) Regulation is often explicitly supposed to promote and protect the industry. (See also Capture Theory). If this is the case, the purpose should be made clear. The FCC does state its purpose, but this stated purpose is not to protect the industry.

a protective and proprietary stance vis à vis the regulated industry. Therefore, in the interests of legitimacy and transparency, regulation can be successfully implemented by an outside agency only if it is subject to regular, independent monitoring and review.⁸¹

The 'institutional' and 'force-of-ideas' theories represent a shift from the calculus of 'who regulates' and alter conceptions about processes of regulation. Institutional theories emphasize the roles of organizational structures and rules in shaping regulation as the entire process of designing regulation is informed by institutional context.⁸² Before looking at the rule-making process, therefore, it is necessary to consider the institutions of both the regulator(s) and regulated interest(s), including their history and development, their evolution from other institutional relationships, and the perceptions of effectiveness that different types of regulation have had in that context. The force-of-ideas theory suggests that regulation is influenced by economic, technical, social, and institutional pressures.⁸³ Force-of-ideas explains why some goals and values are favoured in determining objectives of regulation at any given time.⁸⁴ The 'institutional' and 'force-of-ideas' theories reflect a further expansion of the conception of regulation, and the growing interest in systems-based approaches, self-regulation, and reflexive and responsive regulation.⁸⁵ Disillusionment with the burden and inefficiencies of substantive regulation has also fuelled the development of these approaches,

'Günter Teubner articulated his famous regulatory 'trilemma' of 'circumvention, perversity and negative feedback' that resulted in a pathology of increasingly elaborate and legalised regulation that was ultimately ineffective. Julia Black

⁸¹ H. K. Colebatch, 'Regulation and Paradigms of Organization: Six Theses' in Roman Tomasic and Ric Lucas (eds), *Power, Regulation and Resistance: Studies in the Sociology of Law* (1986) 20.

⁸² Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 27.

⁸³ *Id.*, 18.

⁸⁴ An example of this might be the debate between Butler and Eliot and Manning on the legitimacy of corporations law. Butler and Eliot judge corporations law a success because they focus on utility (i.e. a useful tool to enable economic and productive expansion), while Manning sees it as flawed because his focus is on responsibility (insufficient controls over those in power within corporate organizations). See James W. Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970* (1970) 156.

⁸⁵ Teubner's conception of reflexive law is that it involves a new kind of legal self-restraint. Rather than taking over regulatory responsibility for the outcome of social processes, reflexive law restricts itself to the installation, correction, and redefinition of democratic self-regulatory mechanisms. See Günter Teubner, 'Substantive and Reflexive Elements in Modern Law' (1983) 17(2) *Law & Society Review* 239-286.

summarises these critiques of regulation: [t]he instruments used (laws backed by sanctions) are inappropriate and unsophisticated (instrument failure), ... government has insufficient knowledge to be able to identify the causes of the problems, to design solutions that are appropriate, and to identify non-compliance (information failure), ... implementation of the regulation is inadequate (implementation failure) and/or ... those being regulated are insufficiently inclined to comply (motivation failure).⁸⁶

Iain Ramsay writes that these critiques stimulated a “new learning” on regulation’.⁸⁷ Whereas traditional theories of regulation centred on whose interests prevailed in the regulatory process, criticisms of substantive regulation have created an impetus for the development of self-regulatory mechanisms that are more reflexive and responsive. Later theories, such as the institutional theory, began to take a broader view and more recently, ‘systems’ theory has shifted the focus to communications and organizational principles, feedback and responsiveness.⁸⁸ Adapted from biology and based on communications and organizational principles, systems theory signals a further shift in emphasis from direct intervention to process. It conceives of the organization as a system made up of complex sets of interdependent parts that interact as they adapt to constantly changing environments.⁸⁹ Feedback within the system is critical to enable regulation to be responsive and adaptable.⁹⁰ Consultation and responsiveness to a wide range of interests in regulation are important in the interests of transparency and building trust. Participation also reduces regulatory risks and curbs ‘information monopolies’.⁹¹

The concept of self-regulation is, like systems theory, derived from the biological sciences. Self-regulation is part of the process of homeostasis by which a system regulates its internal environment to maintain a stable, constant condition by means of

⁸⁶ Iain Ramsay, ‘Regulatory Capitalism and the ‘New Learning’ in Regulation’, 28 *Sydney Law Review* 9 (2006).

⁸⁷ Ibid.

⁸⁸ Many of the concepts are related to autopoietic theory as applied to law and other social sciences.

⁸⁹ See *Systems Theory* <<http://www.utexas.edu/courses/spec/class/courses/350/notes/syste350.html>> at 17 October 2005.

⁹⁰ Systems may be open or closed. An open system ‘is a set of objects with attributes that interrelate in an environment. The system possesses qualities of wholeness, interdependence, hierarchy, self-regulation, environmental interchange, equilibrium, adaptability, and equifinality’. ‘Equifinality’ is defined to mean the same results with different inputs or processes. See S.W. Littlejohn, *Theories of Human Communication* (2nd ed, 1983) 32.

⁹¹ See <<http://www.regulatoryreform.com> at 14 April 2007.

multiple equilibrium adjustments, carried out by interrelated regulatory mechanisms.⁹² Multiple, inter-related mechanisms within a system regulate the system itself. 'Self-regulation' is now used generically to refer to any mechanism whereby a subject exercises control over itself to maintain the stability of its function.⁹³ Ogus argues for a wider perspective on this regulatory alternative in order to fully tap its potential.⁹⁴

Self-regulation in business can be defined as 'internal regulation of the industry by the industry through its own procedures.'⁹⁵ Gunningham and Grabosky write that, 'Self-regulation is not a precise concept but, for present purposes, it may be defined as a process whereby an organized group regulates the behaviour of its members.'⁹⁶ In its application to business regulation, self-regulation was originally identified with 'the professions' where rules of conduct and rights of practice for professions were set and enforced by professional organizations. Today self-regulation has extended to other areas, most notably financial regulation.⁹⁷

Self-regulation is also related to the concept of 'decentred' regulation described by Julia Black, among others.⁹⁸ Black proposes decentred regulation as an alternative diagnosis for 'failures' of state-centred regulation,⁹⁹ noting that,

'...complexity, fragmentation and construction of knowledge, fragmentation of the exercise of power and control, autonomy, interactions

⁹² See <<http://iit.ches.ua.edu/systems/homeostasis.html>> at 14 April 2007.

⁹³ As the state of the terminology in this developing field of study indicates, there is no single conception of self-regulation; Black identifies four basic forms of self-regulation as 1) mandated self-regulation: 2) sanctioned self-regulation: 3) coerced self-regulation and 4) voluntary self-regulation. See Julia Black, 'Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World' (2001) 54 *Current Legal Problems* 103, 118.

⁹⁴ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994).

⁹⁵ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998). Note that the Office of Regulation Review (1998) and the Commonwealth Interdepartmental Committee on Quasi-regulation (1999) recommend that, where appropriate, industry should take increased ownership and responsibility for developing efficient and effective regulation having regard to minimum feasible compliance costs.

⁹⁶ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 50.

⁹⁷ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 107.

⁹⁸ For a full discussion on the range of meanings of the term, see Julia Black, 'Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World' (2001) 54 *Current Legal Problems* 103.

⁹⁹ Julia Black, 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1, 4.

and interdependencies, and the collapse of the public/private distinction: all are elements of the composite 'decentred understanding' of regulation.'¹⁰⁰

As opposed to a centralized, top-down process, decentred regulation is derived from the grassroots level,

'In the area of consumer policy decentred approaches appear in a heightened emphasis on self-regulation, the creation of greater opportunities for consumers and others to participate in policy making and implementation...'¹⁰¹

Cooter suggests that centralized law is 'not even plausible for a technologically advanced society.'¹⁰² He states that 'efficiency requires that as economies develop, the enforcement of custom in business communities becomes more important as part of the regulation of business.'¹⁰³

The terms responsive and reflexive regulation are both used in connection with self-regulation. Reflexive law and responsive regulation are emerging concepts that suggest new theoretical perspectives with respect to the function of industries, sectors, and 'systems'. They imply a need for revised processes of regulatory intervention that involve not only greater emphasis on procedure but also greater inclusiveness and participation by all stakeholders.¹⁰⁴

'Reflexion' is a process through which specialised subsystems of society mediate and integrate their functional role in the larger society as a whole; it establishes processes and procedures for private actors to determine their own substantive outcomes.¹⁰⁵

¹⁰⁰ Julia Black, 'Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World' (2001) 54 *Current Legal Problems* 103.

¹⁰¹ Iain Ramsay, 'Regulatory Capitalism and the 'New Learning' in Regulation', 28 *Sydney Law Review* 9 (2006).

¹⁰² Robert D. Cooter and Ulen Thomas, *Law and Economics* (2000) 1647.

¹⁰³ Ibid.

¹⁰⁴ See Günter Teubner, 'Law as An Autopoietic System' (Paper presented at the LSE Complexity Study Group Meeting No 3, London, 18 June 1997); H Willke,, 'Autopoeisis and Organized Complexity' (Paper presented at the LSE Complexity Study Group Meeting No 3, London, 18 June 1997); E. W. Orts, 'Reflexive Environmental Law' (1995) 89 *Northwestern University Law Review* 1227 ; David Hess, 'Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness' (1999) 25(1) *Journal of Corporate Law* 41; W. Eisenberg, 'The Responsive Model of Contract Law' (1984) 36 *Stanford Law Review* 1107. While these terms sometimes appear to be used synonymously, Collins argues that responsiveness and reflexion are distinct concepts. See Hugh Collins, 'Regulating Contracts' in C. Parker, C. Scott, N. Lacey and J. Braithwaite (eds), *Regulating Law* (2004). Günter Teubner explored the distinctions in a 1983 article, 'Substantive and Reflexive Elements in Modern Law', *Law & Society Review*, Vol. 17, No. 2 (1983) 239-286.

¹⁰⁵ For more on autopoietic theory see Günter Teubner, 'Autopoietic Law: A New Approach to Law and Society' in H. Rottleuthner, *The Limits of Law: The Myth of a Regulatory Crisis*, (1989) 17 *International Journal of the Sociology of Law* 273 and Rottleuthner, 'Biological Metaphors in Legal Thought' in Günter Teubner (ed), *Autopoietic Law: A New Approach to Law and Society* (1998).

Reflexive regulation prescribes inclusive procedures for encouraging parties to recognize existing and future problems and to develop their own solutions.¹⁰⁶ The imposition by the regulator of rules and standards is replaced by ‘process, organisation, and the distribution of rights and competencies’.¹⁰⁷ Reflexive law is self-regulation in that the private actors determine substantive outcomes through the reflexive process.¹⁰⁸

‘Responsive’ regulation refers to a collaborative process between a regulator and the regulated interest where the cooperation of the regulated interest offers a better chance of finding a solution. This approach to regulation is also thought to be more inclusive than government intervention alone, and to better represent stakeholder interests.¹⁰⁹

There are several advantages attributed to self-regulation, reflexive and responsive regulation. First, equipped with better knowledge about technical problems in regulating a particular market and a surer sense of what standards are practical, participants are in a better position to tailor rules to a particular market sector.¹¹⁰ Reflexive procedures ensure that various interests and externalities are taken into account¹¹¹ and allow for gradual adjustments.¹¹² Finally, it is thought that values such as individuality and autonomy, formerly protected by formal law, may find a new means of expression.¹¹³

Many governments (for example, Canada and Australia) have espoused the benefits of self-regulation.¹¹⁴ Self-regulation taps into the expertise and technical knowledge of the regulated activity and directly involves the parties who have the best

¹⁰⁶ David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25(1) *Journal of Corporate Law* 41, 136-140.

¹⁰⁷ Sanford E. Gaines and Cliona Kimber, ‘Redirecting Self-Regulation’ (2001) 13 *Journal of Environmental Law* 157.

¹⁰⁸ David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25(1) *Journal of Corporate Law* 41, 51.

¹⁰⁹ Hugh Collins, *Regulating Contracts*, (1999) 65.

¹¹⁰ *Ibid.*

¹¹¹ David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25(1) *Journal of Corporate Law* 41, 51.

¹¹² *Id.*, 136.

¹¹³ They may not appear in a familiar form and instead can be expected to take the form dictated by the interests of the stakeholders involved in the process of regulation. See Sanford E. Gaines and Cliona Kimber, ‘Redirecting Self-Regulation’ (2001) 13 *Journal of Environmental Law* 157.

¹¹⁴ From Soft Law and the Consumer Interest, European Consumer Law Group, ECLG/071/2001 - March 2001 <http://ec.europa.eu/consumers/policy/eclg/rep03_en.pdf> at 22 May 2007.

institutional knowledge about the need for action and about the relative merits of alternative types of action.¹¹⁵ There are several related advantages. Self-regulation may be better targeted to the problems of the industry, not over-broad or under-broad and working with market forces to deliver greater benefits where business is prepared to promise more than the law requires; it is less likely to stifle innovation or excessively limit consumer choice; and it is quicker to develop and more flexible than other types of regulation. Self-regulation can also engender greater mutual trust. Finally, regulatory costs tend to be lower than for more ‘heavy-handed’ forms of government regulation.¹¹⁶ This is because the process incurs lower information search costs while other costs of self-regulation can often be internalized in the industry, reducing the requirements for public funding.¹¹⁷ Self-regulation involves less formalized processes and rules which in turn lead to further cost savings and it can reduce monitoring and enforcement costs as well as the costs to practitioners in dealing with regulators.

Self-regulation can offer flexibility, expert design, and sensitive enforcement, where statutory regulation can be bureaucratic, inexpertly designed, and rigidly enforced.¹¹⁸ Self-regulation, where the regulator ‘agrees to stay out of the detail’, while the regulatee ‘agrees to go beyond the mere letter of the law’, can increase the effectiveness of statutory regulation and at the same time reduce costs and inefficiencies of government intervention.¹¹⁹ Julia Black credits self-regulation with the potential to take the issue of compliance into the boardroom, helping executives ‘see the moral wood from the technical trees’.¹²⁰

¹¹⁵ Governments can hire the technical expertise needed to draft regulations, but this method is slower in perceiving the need for action than where parties are directly involved in the relevant market action. J. Wallace, D. Ironfield and J. Orr, ‘Analysis of Market Circumstances where Industry Self-Regulation is Likely to be Most and Least Effective’ (2000) Tasman Asia Pacific Pty Ltd. <<http://www.consumersonline.gov.au/downloads/selfreg/taskforce/ConsultantReport/ch1.pdf>> at 22 Aug. 07

¹¹⁶ The Office of Regulation Review (1998) and the Commonwealth Interdepartmental Committee on Quasi-regulation (1999) recommend that, where appropriate, industry should take increased ownership and responsibility for developing efficient and effective regulation having regard to minimum feasible compliance costs.

¹¹⁷ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 107.

¹¹⁸ Julia Black, *Rules and Regulators* (1997) 79.

¹¹⁹ *Id.*, 219-212.

¹²⁰ *Id.*, 219.

2.3 THE CURRENT STATUTORY REGULATION OF FRANCHISING

2.3.1 Developments leading to the current Franchising Code of Conduct

The statutory regulation of franchising, the Franchising Code of Conduct, has a self-regulatory element in the involvement of the trade association in its own regulation. It is also self-regulatory in its choice of tools such as disclosure and mandatory mediation that rely heavily on the parties themselves to carry out the regulatory program. The operation of the Code of Conduct also reflects some of the issues of capture, and institutional and force-of-ideas theories of regulating.

Franchising first attracted the attention of regulators in Australia in the mid-1970s; the attention has been continual and the attraction has not stopped yet. In 1976 the Trade Practices Act Review Committee (the Swanson Committee) expressed its concern over the termination of franchise agreements. In 1979 the Trade Practices Act Consultative Committee (the Blunt Committee) recommended a general law with respect to franchising, pursuant to which the Petroleum Retail Franchise Act was enacted in 1980. There were at that time no other laws in Australia specific to franchising. In 1990 the Beddall Report (Commonwealth) called for a reinvestigation of franchising, especially with respect to issues of 'fairness'.¹²¹ In December 1990 the Federal government set up a Franchising Task Force to report on the potential of self-regulatory codes to counter market failure in franchising. In 1993 the Task Force introduced a voluntary Franchising Code of Practice (the Code of Practice).¹²² From 1993 to 1996 this voluntary Code of Practice applied to all members of the Franchise Council, but franchisors were not subject to any requirement to become members of the Franchise Council.¹²³

In 1994 a Review of the Franchising Code of Practice (the Gardini Report)¹²⁴ was charged with 'identifying best practice in franchising and enhancing the effectiveness of the Code to promote an environment which will guarantee the continued growth

¹²¹ That report recommended disclosure and a cooling-off period.

¹²² Jolene Lim and Lorelle Frazer, 'The effect of regulation: An analysis of the Australian Franchising Code of Conduct' (Paper presented at the 15th Annual International Society of Franchising Conference, Las Vegas, February 24 – 25 2001).

¹²³ The Gardini Report estimated that approximately 40 to 50 percent of franchisors had not registered under the Code. Robert Gardini, *Review of the Franchising Code of Practice*, Canberra: A.G.P.S., October 1994.

¹²⁴ Robert Gardini, *Review of the Franchising Code of Practice*, Canberra: A.G.P.S., October 1994.

and success of franchising in Australia and fair treatment to parties involved'.¹²⁵ The Gardini Report concluded that the unconscionable conduct provisions of the voluntary code were inadequate, and it indicated the need for a mandatory code. Though the Report did not expressly recommend that the voluntary code be made mandatory, its recommendations would make compliance effectively mandatory because exemption from the Corporations Regulations would only be available to franchisors in compliance with the Code of Practice.¹²⁶ This measure addressed the Report's finding that, 'the main weakness of the Code had been its failure to provide sufficient coverage across the franchising sector.'¹²⁷

The Gardini Report also recommended the following measures:

- Random audits of disclosure documents;
- Protection against defamation for the investigator;
- Establishment of an independent disciplinary committee;
- Extension of unconscionable conduct to apply to conduct not only at formation of the contract, but also during the course of franchise contract;
- Alternative dispute resolution (ADR) procedures and an organization to oversee ADR for franchising;
- Notification by disputing parties to the ADR organization when unsuccessful in resolving a dispute by negotiation;
- Provision by a franchisor of key financial information;
- Annual reporting on the administration and operation of the Code, also for use as an educational document for the franchise sector;
- Funding by Commonwealth, state, and territory governments for educational and promotional materials on the Code; and
- Review of the Code within five years.

Though the Gardini Report provided a comprehensive review of the voluntary Code of Practice, its recommendations were not implemented as changes to that code.¹²⁸ In 1996 the Franchising Code of Practice and the Franchise Council were abandoned. In

¹²⁵ Id.,1.

¹²⁶ Andrew Terry, 'The Regulation of Franchising in Australia: Reviews, Roundabouts and Realpolitik' (Paper presented at the International Society of Franchising 1996 Conference, Honolulu, 17 – 18 February 1996) 10.

¹²⁷ Robert Gardini, *Review of the Franchising Code of Practice*, Canberra: A.G.P.S., October 1994.

¹²⁸ Some of the Gardini Report recommendations (for example recommendations 5, 6, 7, 9 and 10) have since found their way into the current mandatory Code of Conduct. Others have not; these are outlined in the Table 2.1.

response to some high-profile failures in franchising,¹²⁹ the Minister for Small Business and Consumer Affairs requested a report on the adequacy of existing protection for small firms against unfair conduct in commercial relationships. This inquiry, known as the Reid Report, suggested the following measures:

- With respect to retail tenancy, full disclosure to franchisees who sublet from a franchisor;
- Compulsory registration (with a fee) of franchisors;
- Compliance with Codes of Practice;
- Representation of franchisees in merchants' associations;
- Adequate disclosure documentation generally;
- A new administrative body to oversee the voluntary Code of Practice; and,
- Dispute resolution procedures funded through compulsory registration fees.¹³⁰

Pursuant to the Reid Report a nine-member panel was set up to formulate the current Franchising Code of Conduct.¹³¹ The Reid Report met with greater regulatory response than the Gardini Report, but its recommendations were implemented only in part. Table 2.1 below summarises the recommendations of both reports and the implementation status of these recommendations.

¹²⁹ See, for example, *Novamaze v Cut Price Deli* (1995) 128 ALR 540.

¹³⁰ *Finding a Balance: Towards Fair Trading in Australia* (1997) House of Representatives Standing Committee on Industry, Science and Technology - Parliament of Australia <<http://www.aph.gov.au/house/committee/isr/Fairtrad/report/append.pdf>> at 4 December 2006.

¹³¹ The Panel included three representatives each from government, franchisors and franchisees (that is the regulator, regulated and the 'protected interest').

Table 2.1: Implementation Status of Gardini & Reid Report Recommendations

Gardini and Reid Report Recommendations	Implemented
Registration of franchisors (in effect compulsory)	No
Provision in Code for adequate representation of franchisees in merchants' associations	No
Random audits of disclosure documents	No
Protection against defamation for investigator	No
Independent disciplinary committee	No
Extend unconscionable conduct to apply to conduct during course of franchise agreement	Yes
ADR procedures and ADR organization	Yes
Disputing parties to notify ADR organization if unsuccessful in resolving dispute by negotiation	Yes
Franchisor must provide key financial information	Yes
Administering organization must provide annual report regarding administration and operation of the Code, also for use as an educational document for the franchise sector	No
Commonwealth, state, and territory governments to fund educational and promotional materials on the Code	Partially
Review of the Code within five years	Yes, but not transparent
With respect to retail tenancy, full disclosure in cases of franchisees who sublet from franchisor and adequate representation of franchisees in merchant associations	Yes
Compulsory registration (with a fee) of franchisors and compliance with Codes of Practice	No
Adequate disclosure documentation generally and	Yes
A new administrative body to oversee the voluntary Code and,	No
Dispute resolution procedures funded through compulsory registration fees	No

A mandatory code, recommended by both reports, was put into place only after the Reid Report findings. Other key recommendations of the Gardini and Reid Reports that were never implemented include the following:

- registration of franchisors,
- compulsory registration fees,
- funding of dispute resolution by registration fees,
- a new administrative body to oversee the regulation of the sector,
- adequate franchisee representation in industry groups; and
- annual reporting on the administration and operation of the Code.

As there is no registration, there can be no funding of dispute resolution by registration fees. There is also no provision to ensure franchisee representation in industry groups.¹³²

The Franchising Code of Conduct

The finding by both the Gardini and Reid Reports that the voluntary Code of Conduct did not adequately address the regulatory objectives led to the conclusion that the voluntary code should be replaced with a mandatory code. Promulgated in 1998 under section 51AD as part of amendments to the Trade Practices Act (the TPA), the Franchising Code of Conduct ('the Code') was the first mandatory Code of Conduct in Australia.¹³³

The Franchising Code of Conduct might be seen as an example of Gunningham and Grabosky's observation that regulatory regimes often develop in an ad hoc manner, rather than as intentional, integrated systems.¹³⁴ When John Braithwaite wrote that, 'Australia has allowed itself to be buffeted back and forth by the pre-packaged regulatory and deregulatory solutions fashioned in the US and England',¹³⁵ he might well have been thinking of the Franchising Code of Conduct. The mandatory Code of Conduct was modelled largely on the former voluntary code which itself was modelled largely upon US legislation relating to franchising.¹³⁶ The Code also reflects trends prevalent in regulation in the UK,

'In the field of consumer policy, the OFT [Office of Fair Trading] historically favoured informal methods of regulation and its main output during the 1970s

¹³² Pengilley argues that the Reid Report erred in focussing on problems in specific industries, particularly the motor vehicle trade, and generalising them to apply to all types of franchised enterprise. See Warren Pengilley, 'The Franchising Code of Conduct: Does Its Coverage Address the Need' (1999) 3 *Newcastle Law Review* 1, 18.

¹³³ A Grocer's Code will be the second mandatory code; it is due to be put in place in late 2006. A Horticulture Code <http://www.daff.gov.au/agriculture-food/hort-crops-wine/hort-policy/code-of-conduct> and an Oil Code are also now mandatory codes.

¹³⁴ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 13.

¹³⁵ Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993) 97.

¹³⁶ 'Australia's prior disclosure provisions are closely modelled on the US Uniform Franchise Offering Circular (UFOC) model.' - *Deacons on Franchise Legislation* (2006) Franchisebusiness.com.au <<http://www.franchisebusiness.com.au/articles/FC/0C0402FC.aspx>> at 10 July 2006. For a summary of regulations in Australia, see *Legislation and Regulations Relevant to Franchising* (2000)

UNIDROIT

<<http://www.unidroit.org/English/guides/1998franchising/country/Australia.htm#NR5#NR5>> at 4 December 2006.

and early 80s was codes of practice--a form of self-regulation... By 1998, 49 trade association codes had been approved....'

Ramsay notes that capture is a problem in this regulatory formula,

'The development of codes emerged from a process of bargaining between the OFT and the industry. There was no formal process for approval of a code and the Office did not initially issue guidelines for trades interested in developing a code... [and one trader commented that] "the trade quickly learned how to handle OFT officials".¹³⁷

The nature of institutions and the interests they represent are also significant,

'During the 1970s, trade associations had been eager to sign on to codes as a defensive strategy to the possibility of legal regulation and as a method of raising the trade's image'.¹³⁸

¹³⁷ Iain Ramsay, 'Regulatory Capitalism and the 'New Learning' in Regulation', 28 *Sydney Law Review* 9 (2006).

¹³⁸ Ibid.

In the UK in recent years there has been a trend away from these trade association codes,

‘In 2001 the OFT withdrew support from all existing codes and adopted a new approach that emphasises the role of codes in enhancing competitiveness ... This new approach adopts a more standardised, transparent and measurable process for developing codes that is more demanding than the old process. Consumer groups, enforcement agencies and advisory services must be adequately consulted and codes of practice must deliver benefits to consumers beyond the law. A more stringent monitoring process will exist and performance of codes will be subject to review’¹³⁹

In Australia, however, the Franchising Code of Conduct has not been significantly changed, despite the multiple processes of review. The provisions in the former voluntary Code of Practice and the current mandatory Code of Conduct are very similar (See **Appendix A** for a comparison). Instead of diagnosing the reasons why the voluntary system was falling short, and making the appropriate adjustments, one overarching adjustment was made, namely in enforcement. The original code was voluntary; it was not perceived to be effective. The new Code is mandatory, and is therefore expected to function in a superior fashion. Unfortunately, the fact that the Code is now enforceable by the ACCC does not mean that it is enforced. (The lack of established procedures for monitoring and review of the Code and franchisees’ concern about ACCC handling of claims of breaches of the Code of Conduct by franchisors will be discussed further in Chapters Six and Seven).

There was strong political motivation for the institution of the Code.¹⁴⁰ Political pressures often lead to statutory regulation, but this is not necessarily the best formula.¹⁴¹ Warren Pengilley observed that, ‘The way in which the Franchising Code of Conduct was introduced has all the hallmarks of that which a democracy should try to avoid.’¹⁴² Pengilley notes that early drafts of the Code were distributed to select interested parties in confidence, foreclosing any general discussion or debate. When a draft code was publicly released, only eleven working days were allowed for

¹³⁹ Ramsay notes that the codes project is influenced by Porter's ideas of global competitiveness, where the regulatory agency helps industry achieve higher standards. Iain Ramsay, ‘Regulatory Capitalism and the ‘New Learning’ in Regulation’, 28 *Sydney Law Review* 9 (2006).

¹⁴⁰ Warren, Pengilley, , ‘The Franchising Code of Conduct: Does Its Coverage Address the Need’ (1999) 3 *Newcastle Law Review* 1, 2.

¹⁴¹ Julia Black, *Rules and Regulators* (1997) 59.

¹⁴² Warren Pengilley, ‘Competition Regulation in Australia: A Discussion of a Spider Web and its Weaving’ (2001) 8 *Competition & Consumer Law Journal* 2, 101.

commentary. The final code, introduced by a regulation under ministerial power with no Parliamentary debate, was proclaimed as law simultaneously with its public release in June 1998, even though it was not the same draft as the one that had been released for comment. There was no public-private debate as the quotation from Peter Vincent-Jones at the start of this chapter suggests is required. Pengilley concludes,

‘When laws as all-encompassing as franchising, with its vast commercial ramifications on the law of contract, employment and agency, to mention just a few areas, are brought into effect in this manner, one must expect disaster. This is what the Franchising Code is.’¹⁴³

Decades of experimentation with the regulation of the franchise sector in Australia has yielded a wealth of experience. A voluntary Code of Practice was briefly attempted and rejected and replaced by a mandatory Code of Conduct. The Code of Conduct, its provisions borrowed largely from similar legislation in the US, has been subject to extensive review and commentary, but key recommendations of these reviews, such as greater franchisee participation and registration, have not been accepted by government.

Franchising regulation has been the result of political pressure to regulate. The regulatory response, therefore, is likely to be a political rather than a comprehensive solution. The development of franchising regulation has involved a progression from voluntary to mandatory, both employing essentially the same Code (See **Appendix A**). Key Reid and Gardini Report recommendations were not followed, and so franchisees remain under-represented in the regulatory process, there is no separate administrative body to oversee the Code, and there is no registration requirement. Further, there is no discernable delineation of regulatory process and procedures. The procedures used to select the current regulatory measures were inconsistent with best practice (executive fiat, low levels of consultation, limited evaluation of alternative methods, for example no cost-benefit analysis¹⁴⁴). To the extent that there has been

¹⁴³ Warren Pengilley, ‘Competition Regulation in Australia: A Discussion of a Spider Web and its Weaving’ (2001) 8 *Competition & Consumer Law Journal* 2, 100-103. See also See generally Warren Pengilley, ‘The Franchising Code of Conduct: Does Its Coverage Address the Need’ (1999) 3 *Newcastle Law Review* 1, 48.

¹⁴⁴ Fred Anderson et al, ‘Regulatory Improvement Legislation: Risk Assessment, Cost-Benefit Analysis, and Judicial Review’ (2000) 11 *Duke Environmental Law and Policy Forum* 89, ‘Regulatory agencies use a variety of analytic tools, including comparative risk assessment, cost-benefit analysis, and cost-effectiveness analysis, to inform their decisions and provide a degree of credibility to the decisions that are made. When multiple hazards are assessed within a common framework and combined into a single report, the phrase comparative risk assessment is used. Cost-benefit analysis is

any discernable regulatory process, it has, for the most part, been opaque, and has lacked full participation and transparency. Resources allocated to enforcement are limited.¹⁴⁵ Currently there are only ad hoc procedures for monitoring, review and evaluation (partly due to lack of funding for these functions which could have come from registration fees). Finally, there is little education or assistance for prospective franchisees, or for operating franchisees who encounter problems. Nevertheless, the Code is now claimed to represent world's best practice by industry leaders and is held out as a model for other countries seeking to regulate the sector.¹⁴⁶

2.3.2 Regulatory objectives and tools of the Franchising Code of Conduct

The Regulatory Impact Statement for the Franchising Code of Conduct (the Code) lists the 'objectives of government action' as raising standards of conduct in the franchising sector without endangering the vitality and growth of franchising; reducing the cost of resolving disputes in the sector; reducing risk and generating growth in the sector by increasing the level of certainty for all participants; and addressing the imbalance of power between franchisors and franchisees.¹⁴⁷ To achieve these objectives, the Code relies primarily on three regulatory tools:

- First, there are several substantive provisions. The Code mandates a seven-day cooling-off period for franchisees.¹⁴⁸ A franchisor must obtain from the prospective franchisee signed statements that a franchisee has been given

a tool developed by economists and scientists to determine whether a proposed course of action is efficient compared to alternative courses of action. In a cost-effectiveness analysis, the cost of a project is divided by a quantitative (yet non-monetary) measure of effectiveness, such as the number of years of human life saved or tons of pollution removed. The terminology, as defined above, is not universally accepted. Sometimes the phrase "risk analysis" is used to refer to all of these tools. It is well accepted that tools such as risk assessment and cost-benefit analysis offer insight and intellectual discipline to the decision-making process. They can help to identify and evaluate decision options, and achieve more benefits at less cost than otherwise would occur. However, it is also recognized that use of these tools is not a substitute for human judgment in decision-making. Although these tools will have a stronger influence on some decisions than others, there is a broad consensus that they should be used to inform major regulatory decisions by federal agencies.'

¹⁴⁵ Trust more important when enforcement budget is low. See Coulson, Andrew, *Trust and Contracts: Relationships in Local Government, Health and Public Services* (1998).

¹⁴⁶ Andrew Terry, *Fending Off Franchise Failure* (2006) Franchising and Own Your Own Business, <<http://www.franchise.net.au/articles/00/0C03ED00.asp>> at 17 May 2006.

¹⁴⁷ Explanatory Memorandum, Trade Practices (Industry Codes - Franchising) Regulations 1998 (Cth) No. 162 at <<http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrument1.nsf/framelodgmentattachments/77630AD9222B25BCCA256F73000E7654>> at 24 August 2005.

¹⁴⁸ Trade Practices (Industry Codes - Franchising) Regulations 1998 (No 162) (Cth), Clause 13.

advice, or has been told to seek advice but has decided not to seek it prior to signing the franchise contract.¹⁴⁹ There can be no general indemnity of franchisor by franchisee.¹⁵⁰ There can be no prohibition on franchisees' freedom to associate with other franchisees.¹⁵¹ Procedural provisions are required with respect to transfer and termination.¹⁵²

- Second, there are mandatory dispute resolution procedures; all franchise contracts must contain Code-prescribed provisions that require mediation.
- Third, the Code requires extensive information disclosure, particularly at the time of contract formation. A franchisor that intends to enter into, extend or renew a franchise contract covered by the Code must provide to the prospective franchisee at least 14 days prior to signing the contract a copy of the Code, a copy of the franchise contract, and a disclosure document that provides information about contract terms. The Code comprehensively details a franchisor's obligations in relation to disclosure in Annexure One of the Code. Annexure One prescribes a 21-item disclosure document provided to a franchisee 14 days before signing a contract. The following items of information must be included: 1) A seven-day cooling-off period; 2) Details of the franchisor; 3) Franchisor business experience; 4) Litigation proceedings and judgments; 5) Payments made by a franchisor to recruiting agents; 6) Numbers of existing franchises and numbers of franchisees terminated by a franchisor in the last three years; 7) Description of a franchisee's right to use, and judgments pertaining to trademark, patent, design, copyright; 8) Site or territory, exclusivity and franchisor right to change; 9) Supply of goods or services to franchisee; 10) Supply of goods or services by franchisee; 11) Sites or territories; 12) Marketing and other cooperative funds; 13) Payments; 14) Financing arrangements; 15) Franchisor obligations; 16) Franchisee obligations; 17) Summary of other conditions of the franchise agreement; 18) Obligation to sign related agreements; 19) Earnings information; 20) Financial

¹⁴⁹Id., Clause 11(2).

¹⁵⁰ Id., Clause 16.

¹⁵¹ Id., Clause 15.

¹⁵² Id., Clauses 20-23 and Part 4.

details; 21) Updates; 22) Other relevant disclosure information; 23) Acknowledgment of receipt.¹⁵³

- With disclosure a franchisor must also provide a copy of the Code and a copy of the franchise contract. The disclosure process also requires a prospective franchisee to attest that it has consulted with legal and accounting professionals prior to signing the franchise contract or that it has been advised to but has declined to seek such assistance.¹⁵⁴
- In addition to the requirements of Annexure One for disclosure at the time of contract formation, a franchisor must on an ongoing basis also provide financial statements for marketing or other cooperative funds to which franchisees have made financial contributions.¹⁵⁵

(Table 6.1 in Chapter Six details the disclosure requirements of the Code and their relationship to the provisions of the contract.)

2.3.3 Evaluating the Code of Conduct

Monitoring regulation is a complex task; it integrates a range of concerns about maximising compliance, political support, and efficiency, for example, cost/benefit analysis. It is a major undertaking simply to select and prioritize from among the myriad benchmarks that may be used to evaluate regulation. Among the many principles or values that are proposed to guide best practice in regulation are consistency; substantive clarity and simplicity; procedural cost-effectiveness; efficiency and expediency; transparency; accountability; credibility; commitment; fairness; and international harmonization. It is also recommended that there should be predictability as well as flexibility and consultation as well as independence.¹⁵⁶

¹⁵³ The Code is available at <http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrumentCompilation1.nsf/0/4FA9F21A9489DC27CA256F71004E4CCB?OpenDocument> at 30 July 2006.

¹⁵⁴ Trade Practices (Industry Codes - Franchising) Regulations 1998 (No 162) (Cth), Clause 13.

¹⁵⁵ *Id.*, Clause 17. Note that The Code applies concurrently with the *Petroleum Retail Marketing Franchise Act 1980* (Cth) (PRMF Act); see Stephen Giles and Fiona Wallwork, *Franchising and Co-operatives – The Franchising Code of Conduct* (2002) Australian Centre for Co-Operative Research and Development <http://www.accord.org.au/social/infobriefs/franchising_code_of_conduct.html at 1 August 2005.

¹⁵⁶ S. Berg, *Developments in Best Practice Regulation: Principles, Process and Performance*, Public Utility Research Center, University of Florida and Principles of Good Regulation, Better Regulation Task Force London, 2003 at www.brtf.gov.uk, and EASA Best Practice Principles for Self-regulatory

Finally, there should be educational initiatives and mechanism(s) for appeal, monitoring and review.¹⁵⁷ Baldwin and Cave offer a five-part approach to evaluating regulation by identifying ‘arguments’ that they claim to ‘have force’ in debating whether a regulatory scheme is worthwhile. These arguments ask whether the scheme is supported by legislative authority; whether there is an appropriate process of accountability; whether the procedures are fair, accessible and open; whether the regulator is acting with sufficient expertise; and whether the scheme is efficient.¹⁵⁸

To answer some of these questions with respect to the Franchising Code of Conduct there are commentaries, reviews and studies, just as there were reviews and studies of the regulation of the sector leading up to the current Code. First, the Franchising Policy Council (FPC) was set up in 1998 for a two-year period to monitor the function of the new, mandatory Franchising Code of Conduct (the Code).¹⁵⁹ The Council conducted an official review of the Code which began on 1 December 1999, eighteen months after the Code came into effect. The review process finished six months later on 31 May 2000.¹⁶⁰ The following excerpt is taken from the Media Release by the

Systems at <<http://www.adconsult.info/bestpractice/bestpractice.cfm?menulink=true> accessed April 2004.

¹⁵⁷ Studies, cases decided and rules promulgated are regulation inputs, industry performance is output – see S. Berg. Levi lists the principles that ought to guide the design of effective sectoral regulation as follows: 1. independence - to guard against direct political meddling but also against regulatory capture; 2. accountability 3. credibility - the credible threat of financial penalties; 4. transparency - crucial if a regulatory regime is to be credible; 5. clarity - to avoid ambiguity; 6. speed - otherwise the position of some firms could be jeopardized; 7. appeal mechanisms - to ensure confidence in a regulatory regime but not compromise the speed of decision-making; 8. simplicity - facilitates transparency, speed and clarity; 9. periodic review - crucial to enable improvements to be made to regulatory regimes, but it also complements any day-to-day accountability procedures; 10. consistency - without consistency regulatory credibility will be compromised; 11. commitment – to a system of rules and procedures enabling flexibility but which ex post are adhered to by competition authorities; 12. fairness – by clear statements of how efficiency and equity considerations are weighted in decision making. adCONSULT <<http://www.adconsult.info/bestpractice/bestpractice.cfm?menulink=true>> 10 April 2004, Silvana Sciarra, ‘Franchising and Contract of Employment: Notes on a Still Impossible Assimilation’ in Joerges, Christian (eds), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 242. Levi’s list supports the elements enumerated by Berg; as another example of suggested benchmarks. See also Red Tape Task Force – ACT Government, *From Red Tape to a Blueprint for Regulatory Reform* (1995) 79-94. See 2004 communique at <<http://www.pc.gov.au/orr/reform.html>> at 12 October 2005.

¹⁵⁸ Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 77.

¹⁵⁹ This was renewed for another two years to 2002.

¹⁶⁰ Office of Small Business, *Review of the Franchising Code of Conduct: Report of the Franchising Policy Council* (May, 2000), <<http://www.industry.gov.au/assets/documents/itrinternet/ReviewofFCoC.pdf>> at 1 April 2007. See also

Office of the Minister for Employment, Workplace Relations and Small Business to explain the purpose and nature of the review:

‘(T)he Franchising Policy Council will ... evaluate the effectiveness of the Code in meeting its objectives and its impact on the franchising industry in Australia. The Council will also estimate the costs incurred in complying with the Code's requirements and identify options for minimising the compliance burden wherever possible....

Shortly, the Government will commission a survey of the franchising industry's views of the Code and its effects, and on the basis of this survey develop an issues paper for release at the beginning of the review. The Government will call for submissions on the Code at that time....

The Franchising Policy Council will hold public consultation meetings for stakeholders during February and March 2000, and will report to the Government by the end of May 2000.’¹⁶¹

The Terms of Reference of the Review were to identify the level of awareness of the Code within the franchising industry; evaluate the range of business arrangements covered by the Code, and the appropriateness of this coverage; evaluate the effectiveness of the Code in raising the level and standard of industry disclosure; evaluate the effectiveness of the Code's dispute resolution procedures; estimate the indicative range of costs for the franchising industry in complying with the Code, evaluate the extent to which compliance has changed the operating procedures of franchise systems and identify options for minimising the compliance burden wherever possible; evaluate whether the current statutory protections contained in the Code are appropriate; and evaluate any other relevant issues pertaining to the operation of the Code.

As there were no baseline measurements, the results were based on opinions and anecdotal information gathered from surveys and submissions. The Review process was brief; it was announced in December with results reported in May. There was

<<http://mediacentre.dewr.gov.au/mediacentre/AllReleases/1999/August/FranchisingCodeOfConductReviewAndAmendments.htm> at 26 May 2006.

¹⁶¹ The Hon Peter Reith MP ‘Franchising Code Of Conduct Review and Amendments’ (Press Release 26 August 1999),

<<http://mediacentre.dewr.gov.au/mediacentre/AllReleases/1999/August/FranchisingCodeOfConductReviewAndAmendments.htm> at 26 May 2006.

little data on or discussion of franchisee concerns and few of the submissions came from franchisees.¹⁶²

The final product of the review, the *Review of the Franchising Code of Conduct: Report of the Franchising Policy Council*, concluded that the Code could be improved, but only in minor ways; no major problems were identified. Key findings of the review are summarized here. With respect to awareness of the Code within the franchising industry the report recommended further measures to raise franchisee awareness. The Report indicated a diversity of views on the appropriate coverage of the Code, and the definition of franchising.¹⁶³ It found that ‘Franchisors have responded well to the disclosure requirements of the Code’ and that ‘the real issue is the quality of the information and not necessarily the number of categories of information that must be disclosed’. The Report indicated a need to lift awareness of dispute resolution procedures. On the effectiveness of the Code’s dispute resolution procedures, the report repeatedly makes claims to the effect that review of [the Office of the Mediation Adviser] was excluded from the Terms of Reference (ToR) even though ToR 4 and ToR 7 indicated that it should not be excluded.¹⁶⁴ The Franchise Policy Council (the FPC) did ‘urge’ the Office of Small Business to issue a paper on mediation in the franchising industry. This author has not found such a paper.

The costs for the franchising industry in complying with the Code were found to vary widely. Costs of compliance took into account several submissions and two independent surveys as well as the survey commissioned for the study. The range of estimated cost per year was \$2000-\$65000. The Franchise Council of Australia (the FCA) reported an average annual cost per system of \$52,000. Based on this average, if there are approximately 750-800 franchise systems in Australia, the annual cost of compliance to the industry is between \$39,000,000 and \$41,600,000 per year. ‘On balance’ benefits were considered to outweigh costs.

¹⁶² Of 46 submissions roughly 15 percent were from franchisees.

¹⁶³ For discussions of the appropriate definition of a franchise see Warren Pengilly, ‘The Franchising Code of Conduct: Does Its Coverage Address the Need?’ (1999) 3 *Newcastle Law Review* 1 and also Andrew Terry, ‘Comparative Analysis of Franchise Regulation in Asia’, 2002 Proceedings of the International Society of Franchising. Note the exemptions from the Code for employer/employee, partnerships, landlord/tenant, mortgagor/mortgagee, and lender/borrower relations.

¹⁶⁴ See <<http://www.industry.gov.au/assets/documents/itrinternet/ReviewofFCoC.pdf>> at 27 May 2006.

The FPC concluded that the overall statutory protections associated with the Code were appropriate and they were producing beneficial practical outcomes. It was recommended that breach of the Code should not attract fines, that there could be a need to address termination by franchisees, and that the cooling-off period should be retained with possible conditional waiver for low-value service franchises.¹⁶⁵ The Report also suggested broader powers to the ACCC with respect to enforcement, monitoring, and possible registration of franchises.

Finally, in 2006 yet another review of the regulation was commissioned by the government, this time a Review of Disclosure conducted by the Office of the Minister of Small Business. The results were published in 2007 with the Government response. The principal changes to the Code that will be implemented in 2008 are summarized by various sources.¹⁶⁶ What is important to note here is that recommendations of the Review that would have been useful in obtaining information about the sector and in achieving the stated goals of regulation were not accepted by the government, in particular, registration of disclosure documents and an enhanced role for the ACCC in enforcement. These will be discussed further in Chapters Six and Seven.

In addition to government reviews of the regulation of the franchise sector, there have also been academic publications. In 2001 a study was conducted by Jolene Lim and Lorelle Frazer, *The effect of regulation: An analysis of the Australian Franchising Code of Conduct*.¹⁶⁷ This study was conducted in two stages. In the first stage of the study, a mail survey of franchisors compared responses with those of a survey conducted prior to the introduction of the Code.¹⁶⁸ Based on these responses, the study concluded that there were fewer substantial disputes, greater resolution of

¹⁶⁵ Franchising Policy Council, Department of Employment, Workplace Relations and Small Business, *Review of Franchising Code of Conduct* (2000) at 50-53.

¹⁶⁶ See government information at <http://www.industry.gov.au/content/itrinternet/cmsindexpage.cfm?objectId=48A33B79-20E0-68D8-ED9772A05DDC83D5&indexType=Consultative%20forums> FCA summary at <http://www.franchise.org.au/content/?action=getfile&id=771>, Allens Arthur Robinson at <http://www.aar.com.au/pubs/ip/fofaug07.htm>, other law firms also available.

¹⁶⁷ Jolene Lim and Lorelle Frazer, 'The effect of regulation: An analysis of the Australian Franchising Code of Conduct' (Paper presented at the 15th Annual International Society of Franchising Conference, Las Vegas, February 24 – 25 2001).

¹⁶⁸ Colin McCosker and Lorelle Frazer (1998). *Franchising Australia 1998 – A survey of franchising practices and performance*, Franchise Council of Australia.

disputes through mediation than litigation,¹⁶⁹ fewer franchise agreement terminations, fewer transfers and slower growth in the number of franchisors and number of franchise units. A second stage used a multiple case study approach (interviews with six franchisors and six of each of their franchisees across three types of industries) to evaluate the effect of the Code on franchise relationships, through questions about five issues.¹⁷⁰ This part of the study concluded that trust, commitment, communication, power balance and mutual goals are important at all stages of the franchise relationship.

Surveys of franchisors funded by the Franchise Council of Australia have been conducted bi-annually since 2000 by Professor Lorelle Frazer. The survey questions vary with each survey, but included some questions designed to examine attitudes about the Code of Conduct.¹⁷¹ The 2002 Franchising Australia Survey specifically addressed attitudes about regulation. The high cost of complying with the Franchising Code of Conduct and the difficulties and uncertainty surrounding Code compliance were perceived as the main problems.¹⁷² Other responses were that the Code has no power and/or is inadequate, that excessive disclosure documentation is required and that there is over-regulation of the sector generally. Part C of the 2000 Survey specifically addressed the effect of regulation, in particular the Franchising Code of Conduct. Franchisors reported benefits of the Code such as improvements in franchising relationships, greater care in franchisee selection procedures and more detailed record keeping concerning franchisees. As stated above, the survey

¹⁶⁹ The 2002 FCA Survey shows opposite result, more disputes reportedly being resolved through litigation.

¹⁷⁰ These five issues were 1) What concerns do franchisors and franchisees have in relation to the Code? 2) Do franchisors and franchisees see the Code as beneficial or as an impediment to their franchising process? 3) What changes have franchisors made to the operational aspects of their franchise systems as a result of the introduction of the Code? 4) What are the critical factors influencing the various phases of the franchising relationship in relation to the Code? And 5) How does the Code enhance or impede these critical factors in the various phases of the franchising relationship?

¹⁷¹ It is assumed that these surveys were carried out diligently. Nevertheless, they have limitations. First, they inevitably direct responses according to how the design and administration of the survey. Just as it is difficult to prove a negative, it is difficult to survey a negative. If no questions are asked about a particular issue or of a particular group, the survey is not likely to contain much, if any, related information. In this case, in addition to the fact that the surveys were sponsored by the franchisor-dominated industry group, the subjects of the survey were mostly members of that industry group. Though the surveys provide valuable information for understanding the industry from the point of view of franchisors, it is doubtful whether they can adequately reflect the attitudes of the other half of the industry, the franchisees.

¹⁷² Franchising Policy Council, Department of Employment, Workplace Relations and Small Business, *Review of Franchising Code of Conduct* (2000).

participants were primarily franchisors; therefore the findings of the report reflect franchisor concerns, but even so they are inconsistent.

There is further analysis and commentary about the Franchising Code of Conduct in the academic and professional literature.¹⁷³ In particular, Andrew Terry's commentaries offer an invaluable legal perspective on the regulation of franchising based on the author's years of experience and research. Similarly, Warren Pengilley writes from years of experience in commercial law and regulation; his work offers interesting insights on the scope of the coverage of the Code. Frank Zumbo has written reviews on the Code, in particular with respect to changes and refinements. The brief article by Derek Sutherland in 2001 summarized legislated changes to the Code in that year, while the NADRAC review focussed on the mediation requirements of the Code.¹⁷⁴

These articles provide useful insights but none has dealt with the effectiveness of the Code in meeting its stated goals. Even in the official reviews there is only anecdotal evidence, surveys and testimony, mostly from franchisors. Measurement is difficult due to the lack of baseline measurements against which to evaluate any changes in the sector. Having identified what the existing regulatory program consists of; what the studies and reviews have addressed; and how the existing regulatory reform has responded to suggestions for change, this dissertation employs a contractual analysis to evaluate the extent to which regulation is effective. While it is not a comprehensive assessment of all the diverse aspects of regulation that might be

¹⁷³ See, for example, Des Giugni, 'Standards of Franchising Disclosure: The Disclosure Document' (1998-99) *Franchising Law And Policy Review* 84; the National Alternative Dispute Resolution Advisory Council *Review of Franchising Code of Conduct* (2002); Warren Pengilley, 'The Franchising Code of Conduct: Does Its Coverage Address the Need' (1999) 3 *Newcastle Law Review* 1; Derek Sutherland, 'Recent Changes to Franchising Code of Conduct' (2001) *Proctor* 34; Andrew Terry, 'The Regulation of Franchising in Australia: Reviews, Roundabouts and *Realpolitik*', (Paper presented at the International Society of Franchising 1996 Conference); Andrew Terry, 'Life After the Code: The Impact of the Franchising Code of Conduct on the Australian Franchise Sector' (2004) *The Franchise Review*; Andrew Terry, 'Franchise Sector Regulation: the Australian Experience, 2003/2004' *LawAsia Journal*, 57; Andrew Terry, 'A Self-Regulatory Regime for Franchising: the Australian Experience' (1997) 2 *Franchising Research: An International Journal* 123; Frank Zumbo, 'New Regulations for Australian Franchising' (Spring, 1999) 18 *Franchise Law Journal* 154; Frank Zumbo, 'Fine-tuning the Franchising Code of Conduct (2000) 15(9) *Trade Practices Law Bulletin* 114; and Frank Zumbo, 'Australia's mandatory franchising code of conduct: Successes, challenges and lessons (2001) 9(4) *Trade Practices Law Journal* 213.

¹⁷⁴ National Alternative Dispute Resolution Advisory Council, *Review of Franchising Code of Conduct* (2002), at <<http://www.nadrac.gov.au/wwwwithdisputeresolutionHome.nsf/Web+Pages/4C00de78C.htm>> 27 April 2003.

monitored, this dissertation does offer some insights into the question of whether regulation achieves its goals.

The regulatory program for franchising in Australia has taken advantage of the benefits of self-regulatory measures, but there are disadvantages as well. Despite its many potential positive qualities, self-regulation and related principles cannot be considered a regulatory panacea. There are disadvantages and pitfalls. Because self-regulators can exploit their power to protect their own interests with measures that exclude others from the market and establish anti-competitive conditions, self-regulation risks subverting regulation to certain private interests, ‘with self-regulation, regulatory capture is there from the outset’.¹⁷⁵ There is also a failure of separation of powers if self-regulatory functions cover such areas as policy formation, rule-making, rule interpretation, adjudication and enforcement.¹⁷⁶ Self-regulation in the traditional sense may be perceived to offer too much autonomy to the regulated interests, which leads to issues of control, accountability and fairness.¹⁷⁷ In contrast to direct intervention ‘which gets its legitimacy from the democratic process...self-regulation has to get its legitimacy from somewhere else’.¹⁷⁸ There is potential for abuse especially with respect to under-represented interests and the interests of third parties. There are no provisions, for example, designed to protect third party interests in Australia’s franchising regulation.

The issue of participation is critical in self-regulation, as the Vincent-Jones quotation at the start of this chapter points out. This dissertation aims to assess the regulatory program for the franchise sector in a way that reflects the ‘new learning’ on regulation. The next section explains the layers of governance that will serve as the theoretical and structural framework for the balance of this dissertation.

2.4 ‘LAYERS OF GOVERNANCE’

Wider conceptions of regulation expand the range of potential actors in regulatory processes beyond regulatory activity as the province of watchdog government

¹⁷⁵ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 107-108.

¹⁷⁶ *Id.*, 108.

¹⁷⁷ Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 126.

¹⁷⁸ From *Soft Law and the Consumer Interest*, European Consumer Law Group, ECLG/071/2001 <http://ec.europa.eu/consumers/policy/eclg/rep03_en.pdf> at 22 May 2007.

agencies.¹⁷⁹ As more diverse actors are included in the regulatory process, so, too is a greater range of layers, strategies and mechanisms considered part of the regulatory mix. Under the rubric of regulation is a growing literature that explores and defines these processes, participants, strategies, and tools of regulatory activity, as Table 2.2 below illustrates.

Table 2.2: Components of Regulatory Intervention¹⁸⁰

Steps in Regulatory Process	Participants in Regulatory Process	'Layers of Governance'	Processes/ Strategies	Instruments/ Tools of Regulation
Goal setting Design and drafting Interpretation and Enforcement Monitoring and Review	The parties Franchisor Franchisee Third parties customers suppliers banks and investors insurers Regulator(s) Courts	Market Contract Court interpretation Legislation	Types of Rules Linguistic Structure	Cost of Service Incentives Standards Prescriptive Procedural Performance

Some of the influential research and writing in this area emanates from Australian institutions,

‘The Australian “school” of regulation has pioneered the study of “meta-regulation”--the relationship between different layers of regulation--in particular the relationship of external (eg, law) and internal compliance mechanisms.’¹⁸¹

Hugh Collins’ book, *Regulating Contracts*, recently served as the point of departure for a conference about law as regulation and the regulation of law at the Australian National University Regulatory Institutions Network. The papers presented at the

¹⁷⁹ Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ (2003) 66(1) *Modern Law Review* 44-79. The work of S. Macaulay and I. MacNeil among others underpins Collins’ conception of the contractual framework, the relationship, and the deal.

¹⁸⁰ Table assembled from the work of Julia Black, Hugh Collins, Baldwin and Cave, and Gunningham and Grabosky.

¹⁸¹ Iain Ramsay, ‘Regulatory Capitalism and the ‘New Learning’ in Regulation’, 28 *Sydney Law Review* 9 (2006).

conference have been collected in the volume, *Regulating Law*.¹⁸² The introduction to this volume notes that Collins' book is 'the most systematic treatment we have of any field of law as an institution that regulates and is regulated.'¹⁸³ Because they raise issues that are central to the role of law in the regulation of business relationships, fundamental principles and questions raised by Collins' work have informed parts of this inquiry into the mechanisms of the regulation of franchising.

Collins refers to a 'multi-layered system of governance' of contractual relationships.¹⁸⁴ 'Layers of governance' is not a unique term; it is commonly used in reference to the Internet and information systems technology.¹⁸⁵ Collins uses the term in a particular sense, however, to denote regulation that involves less reliance on the judicial system and legislation and greater emphasis on markets and contracts.¹⁸⁶

Based on the work of Collins and others, this dissertation divides regulation into four layers.¹⁸⁷ The first layer of governance consists of private, non-legal mechanisms of regulation through market interaction. The second layer consists of private, non-legal and legal mechanisms of regulation through contract. The third layer is a public or quasi-public layer, court interpretation of contract, and the fourth layer is also public, regulation by statute. Within each regulatory layer, both private and public, there is a range of instruments, processes and strategies. Each of these layers functions interdependently with the others. As the law is said to be a seamless web, so, too, regulation is a web of instruments and interactions.

¹⁸² Hugh Collins, 'Regulating Contract' in C. Parker et al (eds), *Regulating Law* (2004).

¹⁸³ Id., 8. Many others commentators in the fields of regulation of contract include, for example, I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Regulation Debate* (1992) and S. Macaulay, 'Relational Contract Theory: Unanswered Questions' (Paper presented at a Symposium in Honor of Ian R. MacNeil: Relational Contracts: Floating on a Sea of Custom?) (2000) 94 *Northwestern University Law Review* 775, as well as the work of G. Teubner, J. Black and others. It is beyond the scope of this paper to offer a discussion of the various contributions that have been made in the fields of regulation and contract theory and so the author relies on Collins for a partial synthesis of these contributions.

¹⁸⁴ Hugh Collins, 'Regulating Contract Law' in Christine Parker (ed), et al, *Regulating Law* (2004) 29.

¹⁸⁵ There are four 'layers' to the internet: the physical network layer; the logical layer ; the application layer; and the content layer See <http://www.unctad.org/Templates/Webflyer.asp?docID=7680&intItemID=1528&lang=1>, 15 December 2006. There are five 'key layers' to manage technology. See <http://www.capgemini.com/services/soa/governance/> at 10 July 2007.

¹⁸⁶ Hugh Collins, 'Regulating Contract Law' in Christine Parker (ed), et al, *Regulating Law* (2004) 29.

¹⁸⁷ Alan Schwartz, 'Contract Theory and Theories of Contract Regulation' in Eric Brousseau and Jean-Michel Glachant (eds), *The Economics of Contracts. Theories and Applications* (2002) 13.

This chapter offers a brief description of the layers of governance that serve as a structure for this dissertation, including both private and public layers of governance, by means of the market, contract, the judiciary and the legislature. The chapter also outlines some of the instruments and strategies that can be employed within them.

There is also a connection between private layers of regulation and self-regulation. 'Private regulation' is the term used by Hugh Collins to refer to parties' regulation of their own activities through interactions in the market and through the use of private contractual agreements. Self-regulation is not always private regulation, but private regulation is always self-regulation. 'Public regulation' is carried out by public institutions such as the judiciary and the legislature. Public regulation includes quasi-public regulation through court interpretation of the private arrangement as well as regulation through statutory intervention.

Self-regulatory mechanisms can be used in public forms of regulation, for example, voluntary codes of conduct or ethics or statutory intervention that dictates self-regulatory tools which the parties themselves are responsible for implementing, such as disclosure and mediation. The use of self-regulation in conjunction with public regulation is sometimes referred to as 'co-regulation'.¹⁸⁸ In the interests of greater contextualization Collins argues there should be greater emphasis on the market and on contract as negotiated by the parties in the regulation of commercial arrangements.¹⁸⁹ While private law does not take the place of public regulation, its role takes on new significance. In theory private regulation vests control over a commercial relationship in those best equipped to interpret it, the parties themselves. Collins argues that private regulation should be preferred to public, substantive, command-and-control regulation because it is more contextualized, sophisticated and efficient. Collins' preference for private layers of regulation is supported by the work of Braithwaite and others, as, for example, self-regulatory mechanisms populate the base of Braithwaite's 'enforcement pyramid'.¹⁹⁰ This preference for private

¹⁸⁸ Julia Black, *Rules and Regulators*, Clarendon Press, Oxford (1997) at 50.

¹⁸⁹ Hugh Collins, *Regulating Contracts* (1999).

¹⁹⁰ John Braithwaite, 'Responsive Regulation for Australia', in Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993).

regulation is, however, balanced by acknowledgement that it must work in concert with public regulation.¹⁹¹

2.4.1 Market regulation

‘Markets, both domestic and international, are greater potential instruments of control than governments and investors, and financiers in particular, and may have a profound influence.’¹⁹² ‘The market’ as a layer of regulation includes a variety of mechanisms, sometimes referred to as non-legal sanctions.¹⁹³

Non-legal sanctions may be appropriate in the case of flexible or vague commitments, where it makes sense for the participants in a market to self-regulate rather than for courts or regulators that are not experts to intervene; or where the stakes are low relative to litigation costs; or where the sunk costs of the sanctioning system mean that the mechanisms for enforcing the bond are already in place to serve some other social or economic function. They may also be appropriate in certain market situations, such as where transactors closely monitor each other, so that information and competition contribute significantly to the effectiveness of self-regulation; or in a market that involves highly sophisticated transactors, whose knowledge and information allow them to effectively play a significant role in the regulation of market behaviour.¹⁹⁴ In all these instances it may be more appropriate for contractual behaviour to depend on ‘reputation, ethnic and family connections, and other elements of non-legal regulation and not on detailed and carefully written contracts enforced by disinterested courts.’¹⁹⁵

Transaction-specific investment is a non-legal means to control the relationship; it binds the party making the investment, and gives greater leverage to the contracting party who has not made such investment. Another mechanism is the manipulation of a relationship-specific advantage, such as the posting of a ‘hostage’, that is an asset a

¹⁹¹ Hugh Collins, ‘Regulating Contract Law’ in Christine Parker (ed), et al, *Regulating Law* (2004).

¹⁹² Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 22.

¹⁹³ David Charny, ‘Nonlegal Sanctions in Commercial Relationships’ (1990) 104 *Harvard Law Review* 375, 392.

¹⁹⁴ For a detailed discussion of non-legal sanctions, see David Charny, ‘Nonlegal Sanctions in Commercial Relationships’ (1990) 104 *Harvard Law Review* 375, 425.

¹⁹⁵ Eric Posner quoted in Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn State Law Review* 105, 132-3.

party exposes to the control of the other party.¹⁹⁶ Regulation by the market also occurs through market competition for terms and competition for fair complaint mechanisms.¹⁹⁷ The ‘repeat deal’ is another method, but it is of limited utility to franchisees. Because of long-term nature of the franchise contract, there is not likely to be a repeat deal.

Market regulation also has a collective dimension that includes reputation as well as recognition, interpretive communities, corporate social reporting, and codes of ethics.¹⁹⁸ Reputation is particularly effective when information is available in the market and participants have the ability to utilize it. The International Franchise Association (the IFA) has recently added recognition/awards to its program; the Franchise Council of Australia (the FCA) also has awards program for franchisors, but recognition is based primarily on financial success. Interpretive communities are another collective measure; they can provide a shared understanding of rules and context so that less precision and specificity is required in regulatory intervention.¹⁹⁹ Corporate social reporting is ‘[a] means of assessing the social impact and ethical behaviour of an organization in relation to its aims and those of its stakeholders.’²⁰⁰ Finally, many franchise organizations use codes of ethics and/or practice, for example, the British Franchise Association, the Italian Franchise Association, the International Franchise Association (US), the Franchise Association of South Africa, as well as organizations in Canada, New Zealand, the Philippines, Singapore, and Hong Kong. Internationally, the European Franchise Federation also has a Code of Ethics.

Increased emphasis on market regulation offers several practical advantages. As a form of self-regulation it reduces direct legislated intervention. Firms seeking competitive advantage through innovation and development of new products and

¹⁹⁶ Oliver E. Williamson, ‘Credible Commitments: Using Hostages to Support Exchange’ (1983) 73(4) *The American Economic Review* 519-540.

¹⁹⁷ Hugh Collins, *Regulating Contracts* (1999) 288 and 352-355. Such sanctions are used by the franchisor and franchisee, whose relationship is the focus of this paper, but may also be successfully employed by third-party stakeholders, including customers, suppliers, and financiers.

¹⁹⁸ David Charny, ‘Nonlegal Sanctions in Commercial Relationships’ (1990) 104 *Harvard Law Review* 375, 392.

¹⁹⁹ Julia Black, *Rules and Regulators* (1997) 31.

²⁰⁰ David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25 *The Journal of Corporation Law*, University of Iowa, 41-43.

services are considered to have the strongest incentives to give customers what they want in terms of price and quality. Of all the mechanisms of regulating contractual relationships, it is in theory the market that best ensures participation of all stakeholders. Because it represents the highest potential for stakeholders' participation consistent with current conceptions of best practice in regulatory process, market regulation is proposed as a starting point in any selection process of appropriate regulatory mechanisms.

Despite the advantages of regulation by means of market mechanisms, however, market inefficiencies due to information asymmetry, externalities, and imperfect competition occur in the franchise sector as they do in most commercial contexts.²⁰¹ Market relationships do not always represent a balance of interests of all stakeholders. In franchising these inefficiencies may necessitate the use of other regulatory intervention by government agencies. Chapter Three will outline why the market interaction between franchisor and franchisee sets up conditions of imbalance of power and uncertainty. Later chapters will explain the regulation of the relationship by contract and through regulatory intervention, and will assess how these layers of regulation function together to address stated goals of regulation.

2.4.2 Contract as regulation

Contract is a layer of self-regulation designed, drafted and agreed to by the parties, 'Many contracts are therefore analogous to regulation themselves, for they purport to establish binding standards for future conduct...The private law of contract...delegates to the parties a substantial power to fix the rules'.²⁰² Contract is also integrally related to market and non-legal methods of regulation, so there is some overlap in discussing market and contract as means of self-regulation.

As part of the new multi-layered system of governance, the contract is used by the parties to regulate procedurally in the drafting and negotiation of the contract. Once the contract is signed, the standards set by the parties constitute a form of self-

²⁰¹J.Wallace, D. Ironfield and J. Orr, 'Analysis of Market Circumstances where Industry Self-Regulation is Likely to be Most and Least Effective' (2000) *Tasman Asia Pacific* Pty Ltd. <<http://www.consumersonline.gov.au/downloads/selfreg/taskforce/ConsultantReport/ch1.pdf>> at 22 August 07.

²⁰² Hugh Collins, 'Regulating Contract Law' in Christine Parker (ed), et al, *Regulating Law* (2004) xxvi.

regulation.²⁰³ Contract regulates substantively through the contract attributes, such as the standard form and relational attributes. The standard form, for example, is cost-effective and efficient for mass transactions, but has potential to impose terms on the non-drafting side that may erode commitment to the deal and the relation. Contract duration is another example; shorter duration may benefit a franchisor at the expense of a franchisee. For this reason some jurisdictions use direct intervention to impose minimum duration for franchise contracts.

Another instrument of regulation by the parties themselves is the negotiation of express contract terms, including hostages and restraint of trade clauses, and terms that specify dispute resolution procedures. Here, effectiveness depends on the bargaining power of the parties and their ability to place a value on terms.²⁰⁴ There are also contract terms implied, for example, by consumer protection legislation such as sale of goods legislation. Standards can be agreed upon also by terms implied by course of dealing. The parties may not specify some terms *per se*, but in the process of contracting they are taken to be aware of mandatory and default rules imposed on them by courts and legislatures.²⁰⁵

Specificity of contract is a regulatory strategy available to the parties themselves; specificity establishes certainty, but sacrifices flexibility. On the other hand, the use of vague terms such as 'reasonableness' may be combined with a permissive character to increase discretion in application and interpretation. Vagueness is consistent with relationships where trust is important. The use of discretion in contracts risks opportunism and hold-up, but is often necessary due to future uncertainty. Trade-offs for granting discretion may include lower costs and price breaks, or they may be less tangible, as they are in franchising contracts.

Not only in entering the contract, then, but also in performing the terms of an agreement the parties 'control' their own interaction. The standards in the contract comprise a form of self-regulation that develops throughout the performance of the

²⁰³ Hugh Collins, *Regulating Contracts* (1999) 63.

²⁰⁴ Where a hostage is required, it is better to offer one that is of value to you, but not as attractive to the party, so that the hostage is less likely to be taken but that other party. See O. E. Williamson, 'The Economic Institutions of Capitalism' (1986) 17(2) *RAND Journal of Economics* 279. See also Oliver E. Williamson, 'Credible Commitments: Using Hostages to Support Exchange' (1983) 73(4) *The American Economic Review* 519-540. See also Franchise Contracts, Antony W. Dnes *The Nottingham Trent University*, at <<http://encyclo.findlaw.com/5890book.pdf>> at 10 May 2007.

²⁰⁵ Hugh Collins, *Regulating Contracts* (1999) 63.

contract. Contractual terms are typically used by individual parties, but are amenable to collective regulatory initiatives, as will be discussed in Chapter Seven

Contract is important in many aspects of regulation, but it is only one piece of the regulatory process. Like every other layer of regulation, it has drawbacks as well as strengths. One issue that will be addressed further in this dissertation is the extent to which the contract as a form of regulation represents the views of all stakeholders. In franchising the contract is drafted and controlled by a franchisor. As a regulatory tool it serves the interests of a franchisor, which are often not aligned with the interests of franchisees (or those of other stakeholders). A franchise contract therefore may not represent the interests of all stakeholders.²⁰⁶ Where private mechanisms fail, public regulation may be needed to fulfil the necessary regulatory function.

2.4.3 Court interpretation

The judiciary is another layer of regulation; its primary role lies in interpretation and enforcement of contracts and statutes, as the judiciary supports both the private self-regulation of the contract as well as legislated rules,²⁰⁷ ‘the court system, generally regarded as having nothing to do with regulatory activity, can be a regulator as well as enforcing laws compelling market activity.’²⁰⁸

Court interpretation of contract involves express and implied terms, using literal and contextual interpretation. Courts may employ particular methods for the interpretation of certain species of contract (for example the standard form and relational) and courts may regulate through default rules of contract. Implied terms include good faith, unconscionable conduct, fiduciary duties, and/or a duty of care. Courts thus engage in evaluations of fairness, both procedurally (of the process, formal requirements and criteria for validity) and substantively (of the intentions of the parties, taking into account explicit terms as well as context and implicit understandings). The extensive debate over default rules analysis²⁰⁹ underscores the

²⁰⁶ Regarding stakeholder analysis see S. Watson and G. Gunasekara, ‘Regulating Business Format Franchising: Familiar Solutions for Novel Problems’ (2006) 12 *NZBLQ* 174.

²⁰⁷ Hugh Collins, *Regulating Contracts* (1999) 67. Though the courts have a limited role in planning and design, parties are cognizant of possible court interpretations of their agreements. The posture of the courts thus impacts both upon the parties themselves and upon external, third-party interests.

²⁰⁸ Warren Pengilley, ‘Competition regulation in Australia: A Discussion of a Spider Web and its Weaving’ (2001) 8 *Competition and Consumer Law Journal* 51.

²⁰⁹ See Jay M. Feinman, Relational Contract and Default Rules, 3 *Southern California Interdisciplinary Law Journal* 43 (1993); Omri Ben Shahr, ‘Agreeing to Disagree: Filling Gaps in Deliberately

uncertainty over the circumstances under which parties' intentions should be considered insufficiently clear or not to be enforced.²¹⁰

When courts do interpret contracts based upon extrinsic values, there is no definitive and immutable determination of collective interests and no procedure to establish which competing values and interests should guide the courts' interpretations and interventions. The inevitable vagueness of principles of unfairness, unreasonableness, good faith and unconscionable conduct results in uncertainty for contracting parties' planning purposes.²¹¹ They are all subject to wide variation in judicial application, and the courts exhibit varying degrees of restraint or lack of restraint in interpretation. Günter Teubner observes,

'Law lost its formalism as the politicization of contract law has increased since the 1960s... Judges often corrected and rewrote contracts in order to translate the policy goals of legislation into contracts.'²¹²

Extra-contractual duties such as promissory estoppel, restitution, and duty of care further compound problems of interpretation.²¹³ In interpreting contract law the courts may be forced to rely upon the same filtering devices as tort law, for example proximity, duty, causation, remoteness, but with these devices come the same problems of subjectivity and indeterminacy.²¹⁴

Collins argues that private regulation by the parties is less effective due to lack of particularity in contracts and courts' inconsistent and unpredictable interpretation of fairness, reasonableness, and good faith. This is why courts need access to reliable data to inform their deliberations. The courts have a role in regulatory process, but a role that relies upon and must be informed by the other tools in the multi-layered system.

Incomplete Contracts', University of Michigan John M. Olin Center for Law and Economics Working Paper Series (2004) Paper 2; and George Dent, 'Lawyers and Trust in Business Alliances' (2002) 58 *The Business Lawyer* 45.

²¹⁰ Juliet Kostritsky, 'When Should Contract Law Supply a Liability Rule or Term: Framing a Principle of Unification for Contracts', 32 *Arizona State Law Journal* 1283 (2000).

²¹¹ Hugh Collins, *Regulating Contracts* (1999) 232.

²¹² Günter Teubner, 'Law as An Autopoietic System' (Paper presented at the LSE Complexity Study Group Meeting No 3, London, 18 June 1997).

²¹³ See David Charny, 'Nonlegal Sanctions in Commercial Relationships' (1990) 104 *Harvard Law Review* 375.

²¹⁴ Extra-contractual duties that arise with promissory estoppel, restitution, and tort further compound problems of interpretation of contracts. See D. Charny, 'Nonlegal Sanctions in Commercial Relationships' (1990) 104 *Harvard Law Review* 375.

2.4.4 Statutory intervention

Statutory intervention (also known as state, legislative or direct intervention – see definitions in the Introduction) is regulation in the commonly-used sense of the term, formal, legislated regulation by a governmental organization or agency. The term ‘command-and-control’ is also sometimes used to refer to this type of regulation.²¹⁵ Statutory regulation may impose substantive requirements, such as prescriptive and/or performance standards. It may also involve procedural standards such as information disclosure; cooling-off periods, licensing and registration. Procedures may also be prescribed for example for dispute resolution and public education programs.

There are two fundamental purposes for statutory intervention in commercial enterprise; the first is to promote efficient markets, and the second is to protect the public welfare (including franchisees as consumers and as small businesspeople, and third parties such as end-user consumers, suppliers, and creditors).

While markets, through competition, are generally considered to be the most efficient means of allocating society’s resources, competition does not lead to efficient and equitable outcomes when its operation is hindered by information asymmetry, externalities, moral hazard and transaction costs.²¹⁶ Statutory intervention in commercial activity ‘corrects’ these market imperfections in the interests of economic efficiency and social values.²¹⁷ Regulation helps to ensure efficient markets by balancing unequal bargaining power and information asymmetry, and it can reduce the impacts of transaction costs, moral hazard and externalities.

Statutory intervention addresses a variety of forms of market failure in the construction of markets and in the distribution of outcomes of market interactions. Regulation may, for example, be used to ensure provision of socially desirable products and services where free market competition fails to provide continuity and

²¹⁵ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 39. This text includes a discussion of the pros and cons of direct regulation, and innovations at 40-50.

²¹⁶ Analysis of market circumstances where industry self-regulation is likely to be most and least effective, J. Wallace, D. Ironfield and J. Orr, ‘Analysis of Market Circumstances where Industry Self-Regulation is Likely to be Most and Least Effective’ (2000) *Tasman Asia Pacific* 4 <<http://www.consumersonline.gov.au/downloads/selfreg/taskforce/ConsultantReport/ch1.pdf>> at 22 Aug. 07.

²¹⁷ Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 17.

availability of a good or service; to prevent anti-competitive and predatory pricing practices in order to promote efficient market function,²¹⁸ to allocate scarce goods in the public interest; and/or to ensure the availability of a public good.²¹⁹

Some market inefficiencies occur in the franchising sector, but do not form part of the objectives of the Code of Conduct, though they may be subject to regulation by other legislation, such as competition law. The reduction of transaction costs to improve efficiency, for example, is sometimes a regulatory objective.²²⁰ While the franchise structure itself is a form of governance used by the parties themselves to contain transaction costs, the Code of Conduct does not address this problem. Monopoly is another market inefficiency that is often the object of direct intervention to improve economic efficiency or social welfare, and, though franchising has monopoly characteristics, it is not the aim of the Code to correct these problems. Externalities and spill-over effects, both positive and negative, cause inefficient markets because of costs or benefits not accounted for in the price of goods or services. These, too, are a common problem in the franchise relationship not addressed by the Code.

The Code of Conduct is aimed primarily at the relationship between franchisors and franchisees and is used to address moral hazard and several other types of market failure in that relationship. Moral hazard is defined as, ‘the lack of incentive to guard against risk where one is protected from its consequences’.²²¹ Moral hazard exists where there are incentives to act in ways for which others will bear the cost, for example when the price of a resource is set below its cost. Externalities set up one type of moral hazard, but moral hazard can also be independent of the problem of externalities, as where parties allocate costs equally, though their shares are not equal; or where one party bears the risk, but the costs of risk avoidance are on the other, so that the cost saving does not accrue to the benefit of the party who avoids the risk (an example is the classic moral hazard in insurance contracts). Regulation seeks to contain risks of moral hazard through incentives or monitoring. Other forms of governance to address moral hazard are reputation, pricing, and tie-ins to sales.

²¹⁸ Regulated through the Trade Practices Act, not the Code.

²¹⁹ These categories are taken from Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 17.

²²⁰ Note that regulation can also increase transaction costs.

²²¹ Soanes and Stevenson, eds., *The Oxford Dictionary of English* (2d Revised edition, 2005).

Regulation of franchising addresses moral hazard through substantive provisions with respect to termination and transfer.

Another type of market failure the Code addresses is unequal bargaining power. Where one party to a transaction has greater bargaining power so that the transaction has a reduced likelihood of fairness, regulation can protect vulnerable interests. Another market failure in franchising that is addressed by the Code is asymmetric information; here regulation aims to correct problems caused by information imbalance.²²²

Purposes of regulation not only involve correcting market failure but also risk management, also access to justice, legitimacy, social justice.²²³ Commercial regulation advances public welfare interests, including fairness and distributive justice; restrictions on the exercise of private power; consumer protection; assurance of provision of public goods; and other welfare goals.²²⁴ Consumer protection is intended to reduce the social and economic costs of business' predatory behaviour and 'sharp practice'. Regulation that provides legal protection to consumers and other business participants can benefit business enterprises because parties can be more confident in making investments. Regulation therefore adds stability and can improve the potential of business to raise equity.

Commercial regulation thus has a dual role to play, first, in alleviating market failure and second, in advancing public welfare interests. Regulatory measures often serve both purposes.²²⁵ There are, of course, drawbacks of direct intervention. Statutory regulation can be bureaucratic, inexpertly designed, and rigidly enforced.²²⁶ Substantive law relies on purposive and outcome-oriented direct intervention, for example, it may require that certain contractual outcomes be reached. Direct

²²² This information adapted from Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) at 17. This list is very similar to that provided by Levi, whose five categories of objectives for regulation are transaction costs, free riding, moral hazard, externalities, and information asymmetry. Levi's list does not enumerate social objectives, but focuses on aspects of agency.

²²³ Julia Black, 'Critical Reflections on Regulation' (2002) 27 *Australian Journal of Legal Philosophy* 1, 10.

²²⁴ Hugh Collins, *Regulating Contracts* (1999) 8.

²²⁵ Social welfare legislation also acts for interests that may not be market-related, for example regulation that might advance non-consumer public interests such as anti-discrimination.

²²⁶ Julia Black, *Rules and Regulators* (1997) 79.

intervention may fail to elicit socially responsible behaviour from corporations because society has become too complex for effective control by intervention. Another criticism, known as the ‘juridification’ problem, is that there is ‘too much regulatory law’.²²⁷ The result is that direct regulation can be too complex and distanced from its subjects, overly burdensome, over-broad or under-inclusive. Related to the juridification problem are issues concerning implementation, such as the concern that the regulatory system has become so complex that the legislature must delegate a large degree of discretion to the regulatory agencies. This compounds the problem of ‘normative legitimacy’, that lawmaking procedures have become distanced from the democratic procedures that establish legitimacy.²²⁸ Finally, substantive regulation can encroach on individuality and autonomy, key values formerly protected by formal rules.²²⁹

The principal features of the Code of Conduct, disclosure and mediation, both have potential to advance market efficiency and to provide consumer protection. Both are low-intervention, and have a self-regulatory flavour, as much of the effectiveness of the operation of the regulation depends upon the parties themselves. The burden on the parties in the regulation of this sector in this way, however, must overcome some significant market inefficiencies with respect to information asymmetry, power imbalance and moral hazard. These are discussed in greater detail in Chapter Three and subsequent chapters.

2.5 TOWARDS A MODEL OF BEST-PRACTICE FOR REGULATION

Determining best practice in regulatory process for regulation of any particular sector or industry is a complicated task. With the rapid developments in concepts of best practice in regulation, there is a wide range of approaches to tailoring best practice for regulation of specific types of activities or sectors, for example workplace health and safety, utilities, environmental regulation, and regulation of professional services. There is, as yet, no formulation of best practice for regulation of the franchise sector, so this research looks to some general principles of best practice in commercial

²²⁷ David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25(1) *Journal of Corporate Law* 41, 135.

²²⁸ *Id.*, 50 and 139.

²²⁹ Sanford E. Gaines and Cliona Kimber, ‘Redirecting Self-Regulation’ (2001) 13 *Journal of Environmental Law* 157.

regulation. A reliance on general principles of best practice in regulation is problematic, however, not only because regulation should ideally be tailored to the needs of the activity being regulated. Another problem is the diversity of formulations of best practice in regulating. Three different, respected authorities offer three somewhat different conceptions of how to design regulatory process.

The first is based on the work of Neil Gunningham, a lawyer, together with social and political scientist, Peter Grabosky. Gunningham and Grabosky have written that regulatory process should use a complementary instrument mix, as varied methods can reinforce and support each other. It should prefer less intervention, because direct intervention is not as efficient, effective or as politically acceptable as self-regulation.²³⁰ It should also allow for escalating regulatory response up an instrument pyramid that should include government, business and third parties (and that builds in regulatory responsiveness and triggers); and for use of third parties as surrogate regulator. Finally, they recommend that regulation should encourage business to move beyond compliance.²³¹ Often, this is accomplished through increased self-regulatory measures.

The second conception of regulatory best practice is supplied by the work of Professor Anthony Ogus. Ogus makes some recommendations for regulatory process:

- 1) Identify the issue – keep regulation in proportion to the problem;
- 2) Keep it simple – go for goal-based regulation;
- 3) Provide flexibility for the future – set the objective rather than the detailed way of making sure the regulation is kept to;
- 4) Keep it short;
- 5) Try to anticipate the effects of regulation on competition or trade;
- 6) Minimize costs of compliance;
- 7) Integrate with previous regulations;
- 8) Make sure it can be effectively managed and enforced;
- 9) Make sure it will work and that you will know if it does not; and

²³⁰ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 391.

²³¹ *Id.*, 387-422.

10) Allow enough time.²³²

The third source is taken from the OECD principles for best practice in regulation. These principles are as follows:

- 1) Serve clearly identified policy goals, and be effective in achieving those goals;
- 2) Have a sound legal and empirical basis;
- 3) Produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account;
- 4) Minimise costs and market distortions;
- 5) Promote innovation through market incentives and goal-based approaches;
- 6) Be clear, simple, and practical for users;
- 7) Be consistent with other regulations and policies; and
- 8) Be compatible as far as possible with competition, trade investment-facilitating principles at domestic and international levels.²³³

Australia has adopted the OECD principles. In addition, a 2006 Taskforce report, 'Reducing Regulatory Burdens on Business', has also endorsed the following 'Principles of good regulatory process':

- 1) A case for action should be clearly established (includes evaluating and explaining why existing measures are not sufficient to deal with the issue);
- 2) Policy options need to be assessed within a cost-benefit framework (including analysis of costs and risk);
- 3) Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted;
- 4) Guidance should be provided to regulators and regulated parties to ensure that the policy intent of the regulation is clear, as well as what is needed to be compliant;

²³² Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 339. See also *Regulatory Reform* (2006) Jacobs & Associates <<http://www.regulatoryreform.com>> at 24 November 2006 outlining five characteristics of regulatory systems.

²³³ *OECD Guiding Principles for Regulatory Quality and Performance* (2005) Organisation for Economic Co-Operation and Development <<http://www.oecd.org/dataoecd/24/6/34976533.pdf>> at 2 November 2006.

- 5) Mechanisms such as sunset clauses and periodic reviews need to be built into legislation to ensure that regulation remains relevant and effective over time;
- 6) There needs to be effective consultation with regulated parties at the key stages of regulation-making and administration.²³⁴

This is a sampling of the many proposed approaches to best practice generally. There are many variables and inconsistencies. Sorting through the many formulations of best practice in regulatory process is confusing and lends itself to picking and choosing from among them in order to arrive at the conclusion that whatever the nature of a regulatory program may be, it complies with some formulation of best practice. There are, however, some common themes and concepts that recur across many of the various formulations of best practice. They include, for example, simplicity, identifying the problems, orientation to ends and goals, choosing the right tools, inclusive and self-regulatory process, less intervention, more responsiveness, and greater participation. Julia Black summarizes the new ‘normative propositions’ of regulatory strategies, suggesting that, ‘they are hybrid (combining governmental and non-governmental actors), multi-faceted (using a number of different strategies simultaneously or sequentially), and indirect.’²³⁵ The impetus for these strategies derives from systems theories, involving a process of coordinating and balancing interactions between actors and systems using a variety of techniques.²³⁶

2.6 CORE ELEMENTS OF REGULATORY PROCESS

Emerging empirical research on regulation offers some fresh perspectives on the variety of means and processes available for any particular regulatory purpose.²³⁷ No one instrument or layer of regulation is always the right one, but greater legitimacy

²³⁴ See <<http://www.treasury.gov.au/contentitem.asp?ContentID=1141&NavID>> at 17 September 2007.

²³⁵ Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World', 54 *Current Legal Problems* 103 (2001) 11.

²³⁶ Labelled by some as the strategies of the ‘new regulatory state’, these include proceduralization, collibration, feedback loops, and ‘above all countering variety with variety.’ See Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a "Post-Regulatory" World', 54 *Current Legal Problems* 103 (2001) 11.

²³⁷ See, for example, Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998). Consider also studies such as Lisa Bernstein, ‘Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry’ (1992) 21 *Journal of Legal Studies* 115.

can be achieved if all layers of governance are considered as part of a process of regulation that is participative, democratic and reflexive. Thus, current theories of regulation have shifted in focus from interests and outcomes to process. Within these democratic, participative processes there are choices to be made among different levels of regulatory action, different instruments, and different strategies within each layer. This implies also a need to consider synergies and contra-indications for the various mechanisms and tools used in regulation.²³⁸ Equipped with a more comprehensive perspective of how each layer of regulation works and how the mechanisms of regulation work within them, it should be easier to identify the interactions and synergies among them. It should also be easier to evaluate the need for adjustment in any particular mechanism in the layers of governance.

While much of what is written about new conceptions of regulation is devoted to the instruments of regulation, it must be remembered that these new conceptions of regulatory activity call for a broader range of actors. Braithwaite's 'enforcement pyramid' is populated by tools, but as he himself explains,

'There is no standard or optimal pyramid advanced here as providing a simple model for solving all our regulatory problems. ...The important conclusion is about the need to move our regulatory institutions away from the simplistic and mechanistic models of economic rationalism, legalism and government command-and-control. This means genuine empowerment of all the stakeholders in a regulatory dialogue where each stakeholder comes to understand the concerns of the other and stands ready to respond positively to them so long as their own concerns are responded to positively by others.'²³⁹

The regulatory pyramid might better be thought of as a matrix. Regulatory process now encompasses various levels and tools of regulation, but the relationships among them are not linear.²⁴⁰ Regulation may be voluntary, or it may involve self-regulation. It may involve direct intervention or co-regulation. The challenge is, through designing and refining a matrix of regulatory tools, to identify the most efficient and effective mix of tools to accommodate the dynamic requirements of any given

²³⁸ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998).

²³⁹ John Braithwaite, 'Responsive Regulation for Australia', in Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993).

²⁴⁰ Neil Gunningham and Darren Sinclair, *Designing Smart Regulation*, <<http://www.oecd.org/dataoecd/18/39/33947759.pdf>> at 22 August 2007.

context, whether that context is environmental regulation, financial services, or the franchising sector.²⁴¹

Given the lack of information to inform regulatory policy, legitimacy through expertise by third party regulators is not a solution for the regulation of franchising due to the low likelihood of generating the required level of interest and funding and harnessing the required expertise.²⁴² It is unrealistic to expect a regulator to formulate a regulatory program that comprehends the interaction of all these layers of regulation. Instead, the focus on tools should be balanced by a greater emphasis on the participants and the process of regulating.

Malcolm Sparrow, a leading researcher in theories of regulation and author of *The Regulatory Craft*,²⁴³ has written and lectured extensively on the topic of regulatory process. Sparrow reduces his recommendations to one phrase, 'Pick important problems, and fix them.'²⁴⁴ The key points of the principles of good regulatory process, such as determining the nature and scope of the problem; consideration of cost-benefit; making the regulation clear in terms of policy and compliance; review; and consultation with parties are themes that recur in Sparrow's work, but are reduced to a simple prescription, according to which Sparrow identifies three 'core elements' in reformed regulatory process:

- The first element is a focus on results, which involves rejecting reliance on output measures in favour of 'more meaningful' impact measures.
- The second element is to adopt a problem-solving approach that includes systematic identification of important problems, risk assessment and prioritization.²⁴⁵ Sparrow claims that regulatory craftsmanship requires the

²⁴¹ The work of Hugh Collins; Julia Black; Gunningham and Grabosky; Martin and Cave; and Baldwin, Scott and Hood; among others, call for the expansion, diversification and improved calibration in the use of regulatory tools.

²⁴² While other methods have been proposed as a means to achieve legitimacy in regulation, such as Breyer's expertise of the regulator, they may not be suitable for the franchising context. See Chapter Seven for further discussion.

²⁴³ Malcolm Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* (2000).

²⁴⁴ See Malcolm Sparrow 'PLENARY 4: Effective Regulation' (Paper presented at the John F. Kennedy School of Government, Harvard University at 25th annual conference of the International Organisation of Securities Commissions (IOSCO) Sydney, 14-19 May 2000) <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/\\$file/plen_4_sparrow.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/$file/plen_4_sparrow.pdf)> at 14 September 2006.

²⁴⁵ Also known as "risk-control" or "compliance-management".

use of many different tools, which should be employed to suit the task, not vice versa; '[t]he essence of craftsmanship is having them all, knowing how to use them, and being quite judicious when you will use each one.'²⁴⁶ Sparrow notes that enforcement in particular should not be overlooked or neglected.

- The third element is to invest in collaborative partnerships to form a shared purpose through collaborative agenda setting. Engagement of multiple parties can lead to more effective interventions, and optimal leveraging of scarce public resources.²⁴⁷

Sparrow's prescription is supported by the process recommended by Gunningham and Grabosky in *Smart Regulation*; that process includes determining objectives, defining the character of the problem, and generating the range of available options to address problems and achieve objectives. As the authors note, this process raises the need to build in better consultation and participation.²⁴⁸

Despite its simplicity, Sparrow admits that his prescription is not easy, it has been 'experienced by those who have grappled with it' as different, intellectually demanding, analytically demanding, organizationally awkward and 'unrelentingly difficult'.²⁴⁹ It usually calls for a change in regulatory style, and here, Sparrow's model is not so far from Black's formulations. According to Sparrow, the 'old model', characterized by enforcement was 'reactive, adversarial, incident-driven and 'hard'. The new, 'soft' model, characterized by a re-orientation toward compliance assistance and customer service, is about prevention, partnerships, and problem-solving.²⁵⁰ The substantial challenge for regulatory agencies is 'to construct a framework, so that... innovative methods come forward at the right time, in the right

²⁴⁶ Malcolm Sparrow 'Innovating in a Regulatory Environment' (Speech delivered at the National Environmental Innovations Symposium, Kansas City, 6 December 2000 <<http://www.epa.gov/innovation/symposium/docs/sparrow.pdf>> at 17 September 2007.

²⁴⁷ Malcolm Sparrow 'PLENARY 4: Effective Regulation' (Paper presented at the John F. Kennedy School of Government, Harvard University at 25th annual conference of the International Organisation of Securities Commissions (IOSCO) Sydney, 14-19 May 2000) <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/\\$file/plen_4_sparrow.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/$file/plen_4_sparrow.pdf)> at 14 September 2006.

²⁴⁸ See Gunningham et al, *Smart Regulation: Designing Environmental Policy* (1998) 380-387; for why partic is important see p385.

²⁴⁹ <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/\\$file/plen_4_sparrow.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/plen_4_sparrow.pdf/$file/plen_4_sparrow.pdf)> 29 November 2006.

²⁵⁰ See <<http://www.epa.gov/innovation/symposium/docs/sparrow.pdf>>.

place, for the right job.’²⁵¹ This dissertation suggests that the adoption of such a framework is the first step toward creating an effective and durable regulatory process for the franchising sector.

2.7 CHAPTER CONCLUSION

This chapter establishes a theoretical foundation for an analysis of the effectiveness of the regulation of the franchise sector. Regulation lacks public confidence; the common view of regulation is that it is an undesirable phenomenon. Such attitudes about regulation, however, tend to overlook the importance of regulation in establishing competitiveness. They also lag behind current theories of regulation that have evolved to encompass a broader conception of what regulating is, more diverse actors, and a wider range of regulatory instruments at all the levels upon which they operate. This chapter provides an overview of the current regulation of franchising by the Franchising Code of Conduct and of the reviews of this regulation, not only as an introduction to the subject of this dissertation, but also to situate it in the context of theories of regulatory activity. Next, the chapter introduces the concept of a ‘multi-layered system of governance’ including statute, court interpretation, markets, and contract. In this scheme private and public regulation work together; no one tool is better than another. Regulatory theory has shifted its focus from determinations such as whether public or private is best to an acceptance that they can work together,

‘The insights of the reflexive capacity of private law combined with the collective policy orientation of public regulation can provide the springboard for more productive regulation.’²⁵²

Sometimes market works well to achieve all the objectives, sometimes there is a need for something more, even for substantive regulation. Such an all-encompassing system presents a challenge to any regulator to formulate a regulatory program that comprehends it. This is why the ‘new learning’ on regulation also places a greater overall emphasis on process and why current theories, that continue to be refined with ongoing research, emphasize the importance of self-regulatory and participative processes. This dissertation makes no assumptions regarding the suitability of regulatory tools, as tools are properly selected as a result of process to achieve, for

²⁵¹ See Malcolm Sparrow ‘Innovating in a Regulatory Environment’ (Speech delivered at the National Environmental Innovations Symposium, Kansas City, 6 December 2000) <<http://www.epa.gov/innovation/symposium/docs/sparrow.pdf>> at 17 September 2007.

²⁵² Hugh Collins, *Regulating Contracts* (1999) 361.

any given sector at any given point in time, the optimal mix, selecting from the full range of options, methods, strategies, techniques, and rules.²⁵³ What this dissertation does argue is that, in theory, participative, democratic process helps to improve understanding and enhance legitimacy.

Of the many formulations of best practice in regulation, this dissertation presents one formula, to ‘find problems and fix them’. The three core elements of this formulation of regulatory practice are obtaining meaningful measurements, selecting tools, and instituting collaborative process. At the same time as Collins’ conception of layers of governance comprises the underlying structure of this dissertation, these three core elements are recurrent themes through this dissertation; for example in the discussion of the need for better information in Chapter Three, in the exploration of a range of regulatory tools in Chapters Four, Five and Six, and finally, in the discussion of collaborative process in Chapter Seven. Chapter Two thus provides a theoretical foundation for evaluating the effectiveness of regulation and a direction for the reframing of the regulation of the franchising sector. It is a foundation that rejects casting regulatory activity in a limited role as a necessary evil in favour of a more multi-faceted and versatile role that expands the meaning of regulation; expands the range of instruments, tools and participants; and is truly worthy of public confidence.

2.8 CHAPTER SUMMARY AND RECOMMENDATIONS

This chapter has provided a theoretical framework that will be used in this dissertation to assess the regulation of franchising in Australia. The main points and recommendations are as follows:

- While it is commonly thought desirable to keep regulation to a minimum, such thinking is based on an outdated perception of regulation. There will always be regulation. The choice not to regulate is therefore a choice in favour of the existing regulation. Instead of aiming for less regulation, it would be more helpful to acknowledge that appropriate choices in regulation can be beneficial to the economy; for this reason avoiding regulation can represent a missed opportunity.

²⁵³ For more information on sequencing instrument combinations and multi-instrument mixes see Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 444-447.

- New theories of regulation also frame regulation as a broader function than the traditional view of regulation as rules imposed by government. They have also evolved from outcomes to process. A systems approach to regulation incorporates the advantages of reflexive regulation, self-regulation and responsive regulation, and a range of tools, both private and public. While it does not recommend a particular process, this dissertation does suggest a process-oriented approach to regulation that is relatively simple for all participants to be aware of and to understand.
- Franchising regulation has been the result of political pressure to regulate. Legislation with respect to the sector has been politically motivated and, when implemented, has been borrowed largely from other jurisdictions. It is questionable whether regulation represents a calibrated response to the particular problems and concerns in the sector in Australia, because, as Chapter Three will explain, there is a lack of information about the sector generally, and there are compelling interests in maintaining a positive image of the sector as opposed to obtaining accurate data. The regulatory response, therefore, is more likely to be a political rather than a comprehensive solution.
- The development of franchising regulation has involved a progression from voluntary to mandatory. Both voluntary and mandatory schemes employed essentially the same Code, though there is arguably less enforcement and monitoring procedure in the mandatory version. (See **Appendix A**).
- Key Reid and Gardini Report recommendations were not followed. Franchisees are still not represented, there is no separate administrative body to oversee the Code, and there is no registration requirement. Without registration compliance may still be an issue. Also there can be no funding of initiatives by registration fees.
- A brief overview of the development of franchise regulation in Australia and a review of the literature on the regulation of franchising shows that, while there has been considerable study, there is still no consensus about the effectiveness of the current regulatory program for franchising. This dissertation is a small step toward filling this gap as it assesses the regulation of franchising using the framework outlined in this chapter.

- In this broad sense of governance, regulation is carried out in many quarters on a range of levels, through a range of mechanisms. An expanded view of regulation means that there are more ways to ‘get it right’. ‘Layers of governance’ replace reliance on statutory intervention. These include the market, the contract and the courts as well as legislated regulation.
- At the same time that its capacity is expanded, however, the complexity of the task is increased. While there are many different conceptions of best practice in regulation, given this complexity and the diverse interests represented in regulatory activity, and in particular in franchising, this dissertation argues that it is difficult to overstate the importance of collaborative process in obtaining good measurements, identification of problems and selection of tools.
- Objectives of the Franchising Code of Conduct include redressing imbalance of power and improving conditions of uncertainty. In order to achieve these goals the regulatory process has the potential to provide a framework for balanced power relationships and enhanced understanding among participants in the franchising sector.
- The next chapters consider how regulation currently operates across layers of governance. Chapter Three considers regulation by the market, Chapters Four and Five examine the regulation of the relationship through contract. Chapter Six considers the current statutory regulatory regime.

Chapter Three

Regulation by the Market: An Interaction Characterized by Imbalance of Power and Uncertainty

‘No strategy for resolving conflicts of interest in firms can proceed without extensive knowledge of the firm’s organizational structure and behaviour...institutions come in many different forms, and most of them are complex organizations that are often barely understood, even by those who spend their entire lives in them. To determine how these organizations are likely to respond to different stimuli, we need some systematic knowledge that goes beyond mere intuition.’²⁵⁴

‘Knowledge is power.’²⁵⁵

3.0 INTRODUCTION

Proceeding from the recommendation in Chapter Two of a process-oriented approach to multi-layered regulation, Chapter Three now explores the first of these layers, regulation by the market. Chapter Three provides an introduction to the nature of the franchise sector in Australia in order to orient this research in the particular context to which the regulatory process applies.

This chapter provides the foundation for subsequent chapters of this dissertation in four ways. First, it outlines the fundamental nature of the franchise structure. Chapter Three introduces the legal relationship between a franchisor and franchisee and explains the development of franchising historically as a business form. The chapter then explains some of the social and cultural conditions conducive to franchising, and the economic reasons that underlie a franchisor’s choice of the franchise business model. It also explores the complex motivations behind a franchisee’s choice to participate in franchising. Some of these motivations may be based upon myths about the form; these are also explored in this chapter. Second, this chapter describes the regulation of the sector by the parties themselves through the market, and indicates that imbalance of power and uncertainty, particularly for a franchisee, are conditions

²⁵⁴ Edward L. Rubin, ‘Images of Organizations and Consequences of Regulation’ (2005) 6 *The Cegla Center for Interdisciplinary Research of the Law* 347, 348.

²⁵⁵ Sir Francis Bacon, *Religious Meditations, Of Heresies* (1597).

characteristic of the market interaction in the franchise relationship. Third, this chapter demonstrates that there is a need for more reliable data about the realities of franchising. It outlines the reasons why information about the sector is currently difficult to obtain and suggests that the lack of balanced, reliable information about the sector presents important problems, in particular for franchisees, but also for outsiders, including researchers and regulators, as it hampers research and impedes the design of appropriate regulation. This lack of information also explains why disclosure appears to be a solution, but insufficient information also means that process is deficient, as the first element in Sparrow's regulatory process is to obtain meaningful measurements. Thus, the obvious regulatory solution, disclosure, lacks a solid justification. Fourth, the chapter lays the foundation for later analysis of regulation via the contract because understanding the role of the contract as both an instrument and an object of regulation requires an awareness of the motivations, perceptions and experiences of the contracting parties. This aspect of regulation was introduced in Chapter Two and will be developed further in Chapters Four and Five.

3.1 A BUSINESS STRUCTURE AND A LEGAL RELATIONSHIP

Franchising is an evolving business form. The traditional taxonomy of franchising includes three categories of franchise system, product, manufacturing, and business format franchising.²⁵⁶ The attributes of these types of franchising reflect the historical development of franchising. As with any process of evolution, the lines are not distinctly drawn; a franchise system may fall into more than one of these categories.

The first and simplest is the product franchise. Here, a franchisor is a distributor who supplies goods to a retailer with the understanding that the retailer will have the exclusive right to sell goods in a particular area of the market. This market is usually, but not always, defined in geographic terms.²⁵⁷ Gas stations, car dealerships, and some clothing companies are examples of this type. Early examples of franchising were product franchises, for example the beer franchises in England and Germany of the 1800s, some of which still persist today. The second category, sometimes collapsed into the first, is the processing or manufacturing franchise. Here, a franchisor provides the particular specifications or a specific element which a

²⁵⁶ Andrew Terry and Des Giugni, *Business, Society and the Law* (3rd ed, 2002).

²⁵⁷ Today, the Internet poses a challenge in defining the parameters of a given market.

franchisee uses in producing the product. Soft drinks are the classic example of the manufacturing franchise. The third type, the business format franchise, developed in the post-war period from the mid 1950s. In this type of franchise arrangement a franchisor licences to a franchisee a comprehensive, often extensive operating system. A franchisee must comply with a franchisor's requirements in operating the system or risk losing the franchise. Fast food restaurants such as Subway, hotel chains such as Wyndam, video rental such as Blockbuster, and travel agents such as Flight Centre are all examples of this type. Business format franchising is the most common form of franchise in Australia. Of a total of about 708 franchise systems reported in Australia in 1999, 677 were business format franchises.²⁵⁸

Within the rubric of business-format franchising generally there are many variations. In her award-winning analysis of franchise contracts as incomplete contracts Gillian Hadfield observed, '[t]he threshold problem of defining "franchising" plunges us immediately into the complexity of this modern organizational form.'²⁵⁹ 'Direct franchising' includes both 'unit franchising' (franchisor to individual franchisees) and 'development agreements' (where a franchisee is a 'developer' who secures the right to open a number of units in accordance with predetermined schedule and area.). 'Master franchise' arrangements might involve a foreign franchisor, a local sub-franchisor and local franchisees. There is multi-unit franchising, as well as various forms of licensing and managed-service agreements. The list of possible models of franchising continues to expand. This dissertation deals with the relation between a franchisor and franchisee in its most common form, unit franchising, but it must be acknowledged that even within this category, there is wide scope for variation. There are as many kinds of franchising as there are permutations of licensing, their number and diversity only seem to continue to grow.

This diversity within franchising complicates the problem of defining and governing the sector. Within any jurisdiction there may be legislation that attempts to define franchising. Section 9 of the Corporations Act defines franchise as 'an arrangement under which a person earns profits or income by exploiting a right, conferred by the owner of the right, to use a trademark or design or other intellectual property or the

²⁵⁸ Frazer and Weaven, *Franchising Australia 2002 Survey*, Griffith University and the Franchise Council of Australia Ltd. (2002) at 3.

²⁵⁹ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 930.

goodwill attached to it in connection with the supply of goods or services.²⁶⁰ Effectively, a franchisor grants to a franchisee the ability to sell or distribute products or services which are closely associated with a franchisor's business system, trademark, or other commercial symbol(s). The Franchising Code of Conduct (the Code) contains its own definition. The Code provides that a franchise is 1) a grant by a person to another person of the right to carry on the business of providing goods or services under a system determined or controlled by a franchisor; 2) the operation of the business must be substantially or materially associated with a trademark, advertising or commercial symbol owned or specified by a franchisor, where there is; 3) a payment from a franchisee to a franchisor, for example, an initial capital investment fee; a payment for goods or services; or a fee based on a percentage of gross or net income.²⁶¹

A franchise is a transfer of a right, a type of licence.²⁶² Often it represents the most effective means for an owner of a trademark and other intellectual property relating to a business system to obtain revenue from that intellectual property, while at the same time maintaining the requisite control to preserve and enhance the value of the intellectual property. Despite efforts to define it, a cogent, consistent legal definition of franchising has so far proved elusive. Legal approaches to franchising are rarely straightforward. The franchise relationship has been compared to a joint venture, employment, investment, distributorship, marriage, and sharecropping to name a few. Hadfield writes, 'Such an odd-shaped beast tangles in many areas of the law,'²⁶³ sometimes with grotesque results.

The franchise relationship takes many forms and within each of these forms a franchisor and franchisee play various roles. These multiple roles add to the confusion over the legal nature of franchising. The role of a franchisee is often explicitly stated in the contract, or, more precisely, the contract explicitly states what

²⁶⁰ Robson, *Annotated Corporations Act 2002* (2002) at 92.

²⁶¹ Clause 4 of the *Franchising Code of Conduct*, prescribed by the *Trade Practices (Industry Codes — Franchising) Regulations* (1998).

²⁶² The Federal Court in *Australian Competition & Consumer Commission v Ewing* [2004] FCA 5 considered the distinction between a licence and a franchise. Some commentators have touched upon it, but there is no clear legal distinction. Some distinctions that are noted are that franchising is a licence for the entire system, and that there is greater participation and control by the franchisor than would be the case in a non-franchising licensing arrangement.

²⁶³ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 928.

a franchisee is not. A typical clause might read, ‘Nothing in this agreement will be construed so as to create a partnership or any other relationship between the parties’.²⁶⁴ Table 3.1 shows how the sample contracts define the role of a franchisee.

²⁶⁴ Often in a clause under the heading ‘Franchisee Independence’. The particular clause cited here is from the System F19 contract.

Table 3.1: Contractual Provisions Specifying the Franchisor/Franchisee Legal Relationship ('Franchisee Independence' Clause)

Franchise System	Franchisee is a(n)	Franchisee is NOT a(n) or in
F1	independent contractor	agent, fiduciary
F2	licensor/ee	partner, joint venturer
F3	independent	fiduciary, not employee, agent or partner
F4	franchisor and franchisee	partner, agent, subsidiary, legal representative or employee
F5	franchisee and franchisor	agent, representative or employee
F6	independent proprietor	partner, joint venturer, agent or employee
F7	not specified	partner, joint venturer, agent or other form of fiduciary
F8	independent proprietor	partner, joint venturer, agent, representative or employee
F9	independent contractor	agent, representative, master or servant, partner, joint venturer, fiduciary or any similar relationship
F10	independent	agent, partner or joint venturer
F11	independent contractor	agent, employee, partner
F12	independent proprietor	partner, employee or joint venturer
F13	independent proprietor	Franchisee must clearly exhibit at the location that Franchisee operates under Franchisor.
F14	independent proprietor	partner, representative, agent or joint venturer
F15	not specified	partnership or agency or employment
F16	independent business	partner, joint venturer, agent, employee or fiduciary
F17	independent contractor	agent, partner, joint venturer, employee, subsidiary. No fiduciary relationship duties owed by franchisor
F18	independent proprietor	partnership, agency, joint venture or employment
F19	not specified	partnership, cannot bind the other

As the table indicates, the emphasis is on what a franchisee is not. Most franchise contracts expressly provide that a franchisee is not an agent, subsidiary, representative, legal representative, legal representative, employee, nor in a fiduciary relationship, partnership or joint venture. A contract may include additional language

that further negates an agency relationship such as, '[n]either party has the power to obligate or bind any other party except as authorised by this Agreement.'²⁶⁵

That this contract term is often labelled, 'franchisee independence' offers an insight into the drafter's capacity for irony; in actual practice a franchisee is not independent of a franchisor in its operation. Despite these contractual disclaimers, the contract and the relationship in many ways suggest that a franchisee is like an employee, a distributor, an agent, and/or a joint venturer. There are also many similarities in the role of a franchisee to the role of an investor and also to the role of a consumer of goods and/or services.

Evidence to the contrary notwithstanding, a franchisor wants to avoid the legal burdens of such relationships, and includes an express term that says the relation is none of these things. A franchisor has control, and it uses that control to draft terms like this one to avoid obligations and liabilities and to ensure favourable outcomes when subject to judicial interpretation or legislation.²⁶⁶

3.2 SOCIAL CULTURAL AND ECONOMIC EXPLANATIONS FOR FRANCHISING

3.2.1 Social and cultural explanations

Social and economic explanations for franchising can help to explain the nature of this 'odd-shaped beast'. When Ray Kroc began selling the business format for McDonald's restaurants in the mid 1950s, the social, economic and cultural conditions in America were ideal for growth in the sector. Such conditions include positive attitudes, both politically and socially, toward small business; highly-developed communications systems that facilitate pervasive advertising; and high levels of tertiary activities, such as service and knowledge-based industries with heavy customer interface as well as retail and services that are best served by small,

²⁶⁵ System F7.

²⁶⁶ There is no regulation in the form of disclosure or any other regulatory tool with respect to this contract term. It may be appropriate for a court (or a regulator) to find that one or more of these relationships does exist, even in the face of an express term that states all the relationships that franchising is not. The challenge in interpretation is to comprehend the multiple roles played by the franchisee in the franchise relationship, to consider not only the clause that neatly proclaims the franchisee to be an independent contractor, but to look at all the contract terms, and beyond the contract to consider the entire relationship.

dispersed outlets.²⁶⁷ Television enabled nationwide (and international) brand-name recognition. Increased consumer mobility and an increase in the real income of consumers were further driving factors in the post-war boom in franchising in the US.²⁶⁸ The increased prevalence on a global scale of these conditions has probably contributed to the increase in international franchising in recent years.

3.2.2 Economic explanations

Most of the literature about the economics of franchising deals with the motivations for franchising from the point of view of a franchisor and a franchisor's decision to franchise, specifically why businesses choose to operate as franchises rather than expand through company owned and operated outlets.²⁶⁹ While there is no single, accepted theory of franchising in the marketing and economics research, the two most frequently cited motivations in the choice to franchise are transaction cost efficiency and resource acquisition theory.²⁷⁰ Both are introduced briefly in this chapter. Because the former has been the subject of greater discussion in the literature, more attention is devoted here to transaction cost theory. This chapter will deal first and more briefly with resource acquisition theory. As it deals with reducing the accessibility and the cost of capital, resource acquisition theory might be seen as an aspect of transaction cost theory.

²⁶⁷ Some of the factors described here are derived from the work of Stanworth and Curran. See John Stanworth and James Curran, 'Colas, Burgers, Shakes and Shirkers: Towards a Sociological Model of Franchising in the Market Economy' (1999) 14(4) *Journal of Business Venturing* 323, 344.

²⁶⁸ G. Frank Mathewson and Ralph A. Winter, 'Competition Policy and Vertical Exchange' (1985) 7 *Collected Research Studies*.

²⁶⁹ Williamson describes franchising as a hybrid, federated structure. See also Paul H. Rubin, 'The Theory of the Firm and the Structure of the Franchise Contract' (1978) 21 *Journal of Law and Economics* 223; Brickley, Dark and Weisbach, 'An Agency Perspective on Franchising' (1991) 20 *Financial Management* 27; and Mathewson and Winter, 'The Economics of Franchise Contracts' (1985) 28 *Journal of Law and Economics* 503. For a thorough review of theories of franchising see Sanja S. Mehta and Lou E. Pelton, 'Limitations of Existing Theories: A Need for a General Theory of Franchise Relationships', (Paper presented at the 14th Annual International Society of Franchising, San Diego, February 19-20, 2000).

²⁷⁰ There are other theories for the franchise structure. One is the information search theory. See Antony W. Dnes, 'A Case-Study Analysis of Franchise Contracts' (1993) 22 *Journal of Legal Studies* 367, 391. According to Dnes the franchise contract can be about bonding or screening or a combination of both. Another aspect pertains to relationship management and the desire to keep conflict at manageable levels. Finally, see also entrepreneurial theory in Alanson P. Minkler, 'An Empirical Analysis of a Firm's Decision to Franchise' (1990) 34(1) *Economics Letters* 77.

3.2.2.1 Resource acquisition

According to ‘resource acquisition theory’ the phenomenon of franchising can be attributed to its advantages in capital-raising.²⁷¹ Franchising is a business structure that helps a franchisor raise capital because franchisees provide a source of both start-up and working capital in exchange for the right to use a successful business concept and to operate the franchise unit. A franchisee pays an initial fee, the ‘franchise fee’, as well as royalties and other ongoing service fees. A new franchisee also commits to a lease if applicable, purchases the plant and equipment, pays for the stock and secures the start-up capital to operate the business. Because a franchisee accepts virtually all financial responsibility and risk for establishing and running the new unit, this business structure offers a uniquely effective method of harnessing the financial equity (as well as the ‘sweat equity’) of a franchisee to fuel rapid expansion and increase market penetration for the franchise system.

Franchising enables rapid, steady growth for a franchisor with reduced exposure to business risk. The capital investment of a franchisee provides a franchisor with a low-risk means to meet the capital costs of rapid expansion. A viable business concept in a highly dynamic and competitive market must be implemented quickly, due to the danger of losing market share and brand awareness in markets where new ideas are quickly replicated by competitors.²⁷² Franchising thus enables a business to efficiently manage exponential growth by providing access to capital to fuel expansion in collapsed time frames.

3.2.2.2 Transaction cost theory

The transaction cost theory of economics considers franchising from a principal/agent perspective. While resource acquisition theory has been well-supported in the literature, many studies emphasize transaction cost and agency theory as explanations for franchising. This may be attributable in part to the importance of transaction cost theory in new institutional economics, where it is used in analysis of the governance

²⁷¹ For an overview of economic theories of franchising see Mehta and Pelton, ‘Limitations of Existing Theories: A Need for “A General Theory of Franchise Relationships’ (Paper presented at the 14th Annual International Society of Franchising, San Diego, February 19-20, 2000). See also Sue Birley, Benoit Leleux, Stephen Spinelli, ‘Franchising your Way to Riches? An Analysis of Value Creation in Public Franchisors’, <http://www.babson.edu/entrep/fer/papers97/birley/bir1.htm> at 20 July 1997.

²⁷² See for example, John J. Gillman, ‘Broken Sticks – Why Mergers may fail to Garner Market Share’ (1992) 13(5) *Managerial and Decision Economics* 453, 455.

and structure of the firm. Transaction cost economics uses the transaction as the basic unit of economic analysis, and applies this economic analysis to organizational theory, the law of contracts, and the contracting process to explain the economics of organizations.²⁷³

Transaction costs can be defined as the,

‘heterogeneous costs that arise in economic activity. In many deals, parties have to find each other, communicate, measure and inspect the goods that are to be purchased, draw up the contract using lawyers, keep records, and so on. In some cases, compliance needs to be enforced through legal action. All these entail costs in terms of real resources and time, termed *transaction costs*. The reality of these costs contrasts with the frequent assumption of a perfectly clearing, frictionless market.’²⁷⁴

The term is sometimes used interchangeably with ‘agency costs’ because most transaction costs are related to agency relationships. Transaction costs can be divided into two broad categories. Coordination costs arise from coordinating agents’ activities such as costs of obtaining information and coordinating input in production.²⁷⁵ Motivation costs include the costs of motivating agents to align their interests to avoid cheating or other opportunistic behaviour as well as costs of monitoring.²⁷⁶ Transaction costs may also include liability for other obligations that arise in connection with the relationship, such as franchisor liability for the tortious or contractual liability of franchisees.

Institutional economics types organizational structures as adaptations to economize on transaction costs. Oliver Williamson identifies three critical variables in determining transaction type; these variables are asset specificity, opportunism, and bounded

²⁷³ Nicholas Mercurio and Steven G. Medema, *Economics and the Law* (1997) 147.

²⁷⁴ Craig Calhoun, ed., *Dictionary of the Social Sciences*. Oxford University Press 2002. *Oxford Reference Online*. Bond University. 24 August 2007, <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t104.e1700>>.

²⁷⁵ See Henrik Mathiesen, *Decomposing Costs Into Transaction Costs and Production Costs* (2005) Encycogov.com: The Encyclopedia About Corporate Governance <http://www.encycogov.com/b11researchtraditions/tce/exhi_1decomposetc.asp> at 15 July 2007 which cites the work of George J. Stigler, ‘The Economics of Information’ (1961) 69 *Journal of Political Economy* 213; A. Armen Alchian and Harold Demsetz, ‘Production, Information, Costs and Economic Organising’ (1972) 62 *American Economic Review* 777; and Yorman Barzel, ‘Measurement Cost and the Organization of Markets’ (1982) 25 *Journal of Law and Economics* 27, respectively.

²⁷⁶ Oliver Williamson, *Markets and Hierarchies: Analyses and Antitrust Implications* (1975); Oliver Williamson, *The Economic Institutions of Capitalism* (1985).

rationality.²⁷⁷ According to the concept of ‘asset specificity’, some contractors enjoy advantages over others because they control certain assets, locations or intellectual property. Any potential new contractor must make a start-up investment to attain the same level of advantage and is therefore at a competitive disadvantage. Asset specificity can impair competition in contracts, because of the advantage(s) enjoyed by those ‘advantaged’ contractors, who may at the same time be ‘disadvantaged’ by increased dependency on the specific investment and so on the relationship. ‘Opportunism’ describes behaviour resulting from moral hazard, such as lying, cheating, stealing, incomplete disclosure, misleading conduct, and distortion of information. A party may promise to perform in good faith, but may still succumb to the temptation to benefit its own interests at the expense of the other.²⁷⁸ This makes the promise aspect of contracting inherently unreliable. ‘Bounded rationality’ describes the inability of contracting parties to consider every contingency that may arise in the course of the contracting relationship. Contractors’ rationality is limited by knowledge, communication and future uncertainty. It is impossible to have perfect knowledge because human communication is imperfect and there is no way to perfectly predict the future. Bounded rationality means that contract planning is never entirely effective because it is not possible to predict or to address all contingencies.²⁷⁹

Asset specificity, opportunism and bounded rationality together create conditions that inform the selection of an organization’s governance structure. Certain business structures minimize the transaction costs of producing and distributing a particular type of good or service. Effectively the transaction type determines the choice of governance structure.²⁸⁰ The transaction type is reflected in the contract, or set of contracts binding the participants in the business structure, and this is why these

²⁷⁷ Jules Coleman and Jeffrey Lange, *Law and Economics, Volume I* (1992) xvii.

²⁷⁸ Ethical relativism comes into play here: In the case of incomplete disclosure, for example, the opportunistic party may not see the situation as would the party not receiving the information. Parties to contracts do not necessarily share the same ethical standards, let alone the same standards of good faith and fairness in the deal.

²⁷⁹ Oliver Williamson, ‘Why Law, Economics, and Organization?’ [14] (Working Paper No 37, University of California Berkley, 2000) <<http://groups.haas.berkeley.edu/bpp/oewithwleaorg17b121800.pdf>> at 9 November 2006. See also Andrew Coulson, *Trust and Contracts: Relationships in Local Government, Health and Public Services* (1998) for an interesting application of Williamson’s principles.

²⁸⁰ Oliver Williamson, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) *Journal of Law and Economics* 22(2) 233, 233-261. For his thoughts on the implications of Williamson’s work on regulation of contracts see Collins (1999) at 259.

structures are categorized not simply by the transaction type but also by the kind of contract involved.²⁸¹

Based on the configurations of these styles of contracting, Williamson distinguishes several ‘theories of the firm’, classical, neoclassical, behavioural (also known as forbearance or relational).²⁸² Williamson groups these into categories of enterprise from market to hybrid to hierarchy. The hierarchical is large and vertically integrated, while at the other end of the spectrum, small to medium-sized enterprise displays little vertical integration.²⁸³

According to the ‘classical’ theory, contracting parties and investment characteristics are fungible. There is no asset specificity. Contract terms can be fully specified, so there is no bounded rationality. Remedies can be clear and prescribed, so there is no opportunism. This is the theoretical ideal market transaction, suited to market governance.

Under the ‘neoclassical’ theory, performance is longer term, so there is greater uncertainty. There are specific assets, but the transactions are relatively infrequent. Bounded rationality, opportunism and asset specificity here create a need for a more specialized governance structure than the market of the classical model. But because the transactions are infrequent, the parties themselves will be less inclined to invest, and will instead prefer to leave governance to third party supervision. Trilateral governance, for example arbitration or any process where a third party is involved to assist in the governance of the relation, is therefore the norm to assist with governance and at the same time economize on the costs of neoclassical contracting.

²⁸¹ Regarding the ability of parties to contract in a way that adapts to these variables, Williamson identifies four contracting ‘mechanisms’, planning, promise, competition and governance. Where there are problems of inadequate knowledge or information asymmetry, communication and future uncertainty, planning can be used. Promise limits the scope for opportunism and improves reliability. Competition can be a source of mechanisms to redress imbalance created by asset specificity. Governance provides for greater integration of the activities within the structure of a firm, so that more unified governance can be a solution to many of the transaction cost problems in contracts.

²⁸² Oliver Williamson, ‘Why Law, Economics, and Organization?’ [16] (Working Paper No 37, University of California Berkley, 2000) <<http://groups.haas.berkeley.edu/bpp/oewithwleorg17b121800.pdf>> at 9 November 2006. Williamson also identifies agency, evolutionary and transaction cost theories of contracting, but most law and economics commentary focuses on the first three for which Williamson adopts Macneil’s classification, which identifies three traditions of contract law.

²⁸³ Sciarra criticizes Williamson for being too static, not accounting for changes in relations over time. Silvana Sciarra, ‘Franchising and Contract of Employment: Notes on a Still Impossible Assimilation’ in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991), 256.

Finally, under ‘behavioural’ theory contracts involve specific investment. As with the neoclassical model, the relation is long-term and uncertain, but in this case the transactions are recurrent and involve higher levels of investment. If the investment is not idiosyncratic, a bilateral governance structure may be appropriate. Uncertainty does not matter in market transactions where idiosyncratic investment is low and substitutability is high. Where there is high uncertainty as well as high idiosyncratic investment and recurrent transactions, however, there is a need for unified governance structures.²⁸⁴ As the investment becomes highly idiosyncratic, investment in more specialized governance structures by the parties is justified,²⁸⁵ and there is likely to be greater integration of buyer and seller under a more tightly-controlled, unified system of governance.²⁸⁶

Williamson suggested that franchising conforms to a hybrid model which he described as ‘federated’, where large and small entities are linked. The federated model takes advantage of the disparate economies of scale of linked production and marketing processes, and saves on coordination costs.²⁸⁷ A franchisor can achieve economies of scale of a large operation in cooperative infrastructure for purchasing, product development, and promotion for the system as a whole, all of which can become more cost-effective as a franchise group expands.

This model seems especially apt for larger, more established franchise systems. McDonald’s, for example, can contract for beef on a massive scale in Brazil, while retaining the local ‘touch’ of individual franchise units. The per-unit cost of developing a franchise system may be less than the amount required to open one additional company store. At the same time, through the development and operation of small units, a franchisor is freed of day-to-day unit operation and local market

²⁸⁴ Oliver Williamson, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) 22(2) *Journal of Law and Economics* 233, 254.

²⁸⁵ *Id.*, 245.

²⁸⁶ There are three additional theories that are not discussed here, the agency, evolutionary, and transaction cost theories.

²⁸⁷ See Oliver Williamson, *Markets and Hierarchies: Analyses and Antitrust Implications* (1975); Oliver Williamson, *The Economic Institutions of Capitalism* (1985); Oliver Williamson, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) 22(2) *Journal of Law and Economics* 233, 233-261. The original concept is based on the work of Ronald Coase, which has been developed by Oliver Williamson. Williamson posits that enterprises can be organized along a continuum; from ‘hierarchical’ (that is large and vertically integrated) to ‘market’ (ie small to medium-sized enterprise with little vertical integration). Williamson suggests another category of enterprise along this continuum, or perhaps somewhere alongside it.

concerns, while still receiving information about these functions.²⁸⁸ Thus, franchising allows a business to simultaneously secure the advantages of both large-scale and small-unit operations.

The costs of coordinating specialized agents such as costs of obtaining information, coordinating input in production, and costs of monitoring and measurement are mainly caused by bounded rationality (imperfect knowledge).²⁸⁹ In franchising this means that information asymmetry and uncertainty over future conditions lead to coordination costs, for example, in recruitment and transfer with respect to the selection and substitutability of franchisee. The franchise form helps contain coordination costs by allowing a franchisor to enter into an employment-like relation with a franchisee without the usual costs and risks associated with employment. A franchisee pays to set up the unit, enjoys fewer compensatory benefits, fewer statutory protections and takes on more of the operating risk than would an employee.

Franchising also keeps motivation costs down because a franchisee, unlike an employee, has a financial interest in the performance of its unit. A franchisee's equity investment thus ensures a strong commitment to the success of the business so that a franchisor can reduce costs of incentives and monitoring. Most franchisees directly manage their businesses themselves (as an added assurance they are often required to do so according to terms of the contract). The level of motivation of a typical franchisee is therefore high as it is easier in smaller, specialized firms to motivate agents by closer monitoring and by offering compensation schemes that reward good work.²⁹⁰

Screening of an agent is a coordination cost that can save monitoring costs. A franchisors' investment in screening can reduce motivation and monitoring costs

²⁸⁸ This function gave rise to the 'information search theory' of franchising.

²⁸⁹ See Henrik Mathiesen, *Decomposing Costs Into Transaction Costs and Production Costs* (2005) Encycogov.com: The Encyclopedia About Corporate Governance <http://www.encycogov.com/b1researchtraditions/tce/exhi_1decomposetc.asp> at 9 November 2006 which cites the work of George J. Stigler, 'The Economics of Information' (1961) 69 *Journal of Political Economy* 213; A. Armen Alchian and Harold Demsetz, 'Production, Information, Costs and Economic Organising' (1972) 62 *American Economic Review* 777; and Yorman Barzel, 'Measurement Cost and the Organization of Markets' (1982) 25 *Journal of Law and Economics* 27, respectively.

²⁹⁰ George Dent, 'Lawyers and Trust in Business Alliances' (2002) 58 *The Business Lawyer* 45, n20.

because it selects franchisees who are highly motivated to achieve greater returns on their own equity investments.²⁹¹

The screening process in franchising in Australia is probably deficient both in the screening of franchisees by franchisors and in the screening of franchisors by franchisees. In the former case, the short supply of franchisees in the market for franchises in Australia means that franchisors are more likely to accept franchisees that are less qualified, perhaps even unqualified for the role. In the latter instance, the prospective franchisee is ill-equipped to evaluate franchise systems for a variety of reasons that will be explained in Chapter Six.

To the extent that they can substitute for the screening function, the costs of other methods of controlling transaction costs, such as monitoring, may increase.²⁹² A franchisor may impose tighter monitoring controls to ensure the protection of its brand. The result of ineffective screening is that opportunistic behaviour such as franchisee free-riding, a form of moral hazard where a franchisee shirks on the trade name or brand, may be more prevalent.

For this reason, transaction costs in relation to recruitment and the limited pool of available, qualified franchisees in the Australian market can lead to a choice to integrate, hiring managers for company-owned stores rather than selling franchise units to be operated by franchisees. However, if resource acquisition, information search, or other motivating factors are important, a franchisor may be inclined to accept under-qualified franchisees rather than make the shift to company-owned units.²⁹³

²⁹¹ The franchise relationship in fact presents a double-sided moral hazard. While the accepted theory is that the franchisee is an agent of the franchisor, providing one of the central reasons behind the decision to franchise, the franchisee is also in some respects a principal and the franchisor is an agent who must be screened and monitored before assuming a role where he is able to exercise extensive control over assets provided by the franchisee. B. Elango and Vance H. Fried, 'Franchising Research: A Literature Review and Synthesis' (1997) 35(3) *Journal of Small Business Management* 68, 74.

²⁹² The franchise contract needs to reflect the reality of franchising's bi-directional agency and to protect against the double-edged moral hazard it creates. This monitoring function will require more than contract because the monitoring of a franchisor requires collective action by franchisees: E. Rubin as cited by B. Elango and Vance H. Fried, 'Franchising Research: A Literature Review and Synthesis' (1997) 35(3) *Journal of Small Business Management* 68, 74.

²⁹³ Francine Lafontaine and Margaret E. Slade, 'Incentive Contracting and the Franchise Decision' in Chatterjee, Kalyan and Samuelson, William F.(eds) *Game Theory and Business Applications* (2001).

There are still other ways that franchising allows a franchisor to economize on transaction costs. One is in the drafting and negotiation of contract. Here, as will be described in greater detail in Chapter Four, the contract attributes can reduce costs. For example, a franchisor's use of standard form contracts reduces transaction costs in formation of contract while the relational qualities of contract reduce costs of re-negotiating and resolving disputes. Another transaction cost benefit of franchising is the savings in the cost of obtaining information. As Williamson's 'federated' model highlights, franchising is a way for a franchisor to guarantee free access to market information from many independently-owned local units.

The choice to franchise is thus motivated largely by franchisor considerations of capital efficiency and transaction costs. The infusion of outside capital together with cost savings allow for expansion over widely dispersed markets geographically. Under favourable conditions, such as the adequate supply of well-qualified franchisees, a well-run franchise structure successfully facilitates the rapid recruitment and training of qualified, motivated management. It also contains transaction costs such as coordination, motivation and monitoring costs; drafting and negotiation of contracts; and it facilitates intra-organizational information-sharing and innovation.

3.3 FRANCHISEE PERCEPTIONS AND MOTIVATIONS

Franchisor motivations to franchise are well-documented. Economic justifications dominate the reasons given for the choice to franchise by franchisors. Economic theories of franchising describe why the firm is structured the way it is from the point of view of the organizers of the firm. Economics is less helpful in understanding franchisee motivations because economic theories of organizational structure generally do not give much weight to the extent to which the structure benefits the consumer of the product of the firm, or suppliers or creditors with whom the firm does business. As Louise Sylvan noted,

‘Because of the way industrial economists work, all over the world, the focus in terms of competition outcomes has tended to be on the supply side – in other words, the focus has been on firms.’²⁹⁴

²⁹⁴ Louise Sylvan, ‘Consumer Regulation – How do we know it is effective?’ (Speech delivered at National Consumer Congress, Melbourne, 15 March 2004) <<http://www.atug.com.au/other/ACCCNationalConsumerCongressMarch04.pdf>> at 26 September 2006.

The choice of franchising as a business model can be attributed largely to its risk reduction for a franchisor because a franchisee puts its own resources and capital at risk instead of those of a franchisor. When a franchisor's risk is transferred to a franchisee, however, it is not clear that a franchisee understands the bargain. Generally, in market transaction, including investment transactions, the party that undertakes higher risk is compensated; there is a trade-off between risk and return.²⁹⁵ If a consumer or investor in a transaction fails to understand the nature of the risks, it will also probably fail to ensure it is adequately compensated for assuming risk.²⁹⁶

This may be the province of regulation, but theories of regulation only consider this aspect of a firm's operation as part of an overall program that asks first, whether the operation is efficient. The primary motivation for regulation generally is to correct market failure. If there is market failure, then regulation is warranted. Whether the operation, business structure or the relationship is fair is a harder question, and is not considered an economic one.²⁹⁷ Regulatory activity has traditionally been more dominated by economists than regulators, and the question of fairness has been less prominent as economists have devoted less attention to the consumer, in this case the franchisee, side of the equation.

While a franchisor has a variety of legal and economic reasons for franchising, individual franchisees may not benefit from all the same factors that contributed to a franchisor decision to franchise. A franchisee's reasons to participate in this business form are less dominated by economics, and are more likely to encompass a complex mix of personal, social and financial considerations. In the competition for fewer and fewer qualified franchisees, research into franchisee motivations has been conducted

²⁹⁵ Steven Wu, Ohio State University Fact Sheet, *The Economics of Contracts for Non-Economists* at www.ohioline.osu.edu/ae-fact/0010.html.

²⁹⁶ Ruben (1978; 1990) notes that the risk sharing benefits of franchising that are initially conceived at the franchisor level are negated at the franchisee level. See Sue Birley, Benoit Leleux, Stephen Spinelli, *Franchising your Way to Riches? An Analysis of Value Creation in Public Franchisors* <http://www.babson.edu/entrep/fer/papers97/birley/bir1.htm> at 20 July 1997.

²⁹⁷ Personal interview with Albert Jolink, Director Erasmus Center for History in Management and Economics, Rotterdam at Sophia-Antipolis September 2006. Though this may be changing slowly as the economics of the firm is beginning to look at the impact of the firm's structure. See Michel Aglietta, 'Corporate Governance and the Long-Run Investor', (Paper presented at the Third Meeting of the European Network on the Economics of the Firm (ENEF) GREDEG, CNRS and University of Nice Sophia Antipolis, 7-9 September 2006).

primarily for and by consultants to the sector. Less attention has been devoted to the topic in the academic literature.²⁹⁸

As will be described in the next section of this chapter, extensive lists of reasons to purchase a franchise are disseminated by franchisor industry groups as well as individual franchisor systems. Many of a franchisee's reasons to franchise are based on perceptions that are generated and/or reinforced through franchisor marketing. They include trademark-related benefits such as high levels of brand awareness; a track record that helps assess prospects for performance; collective marketing and advertising; better cooperation from lenders; the possibility for small entrepreneurs to compete with national and international firms; and training, management support, and technical assistance.²⁹⁹ Frequently, these reasons are repeated, but often not proven, in the marketing and management academic literature.

There are also cultural and socio-political factors that contribute to the attraction franchising holds for prospective franchisees. The rise of the entrepreneur to the status of a cultural icon is one intangible aspect of the appeal of franchising to franchisees. On a psychological level franchising combines values of entrepreneurial individualism and independence with the cooperative appeal of a communal/team enterprise. Franchising is seen as a path to making one's own fortune, while enjoying the benefits of both independence and security. Mothers with school-aged children and retirees are 'lifestyle franchisees', attracted to the flexibility and independence of the structure, and to the idea captured in the industry slogan, 'in business for your self, but not by yourself.'³⁰⁰

²⁹⁸ See the website of Greg Nathan, <<http://www.franchiserelationships.com>> and Deloitte Touche Tohmatsu, *Franchisee Satisfaction Survey Benchmark 2004*, <http://www.deloitte.com/dtt/cda/doc/content/franchise_survey_lo-res.pdf> at 29 December 2005. See also Kaufman, and Stanworth, 'The Decision to Purchase a Franchise: A Study of Prospective Franchisees' (1995) 33 *Journal of Small Business Management* 22. and Stanworth and Curran, 'Colas, Burgers, Shakes and Shirkers: Towards a Sociological Model of Franchising in the Market Economy' (1999) 14(4) *Journal of Business Venturing* 323.

²⁹⁹ Franchisors may choose to avoid offering this and other services unless they generate additional fees.

³⁰⁰ *Working for yourself not by yourself: are you suited?* Franchisebusiness.com.au <<http://www.franchisebusiness.com.au/articles/C9/0C03BFC9.aspx>> at 15 July 2007; *Be in Business for Yourself, not by Yourself!!!* (2006) Blue Horizon Group <<http://www.bluehorzongroup.biz/page/page/1682226.htm>> at 4 July 2006.

Franchising is often portrayed as a safer route into self-employment with or without prior self-employment.³⁰¹ Franchisors market franchising as a sensible option for middle-managers who have been made redundant; for semi-retired people turning to 'lifestyle' franchises to fill a gap and provide a needed boost to income; and for divorced women, widows, and others with poor employment prospects but a small 'nest egg' who see franchising as a safer way than independent small business for a less experienced person to get started in business ownership. These prospective franchisees believe they are 'buying themselves a job', and ensuring their future incomes.

The perception is that the existing successful name and reputation of the franchise system increase a franchisee's chances of success and that the 'tried-and-tested' quality of the business system reduces the risk to a franchisee in the new unit operation. The industry commonly cites information about success rates for franchising as compared with independently operated small business. A US government website advises, 'If you are concerned about the risk involved in a new independent business venture, then franchising may be the best business option for you.'³⁰² Australian franchisors claim that, 'Franchising is 2.5 times more successful than non-franchised business.'³⁰³ A franchisee's perception of the reduced risk of a franchised business may be one of the most important components of the promise of franchising.

In some cases, however, the element of reduced risk may be more perception than reality. A 2006 article in Fortune Magazine re-ignited debate in the US over franchise success rates.³⁰⁴ The relative success of franchising as a method of doing business has not been conclusively measured, for example, using failure rates for franchises as compared to those of independent small business, but some research indicates that, 'franchising is not a low-risk form of business enterprise, for franchisors or

³⁰¹ B. Elango and Vance H. Fried, 'Franchising Research: A Literature Review and Synthesis' (1997) 35(3) *Journal of Small Business Management* 68, 71-72.

³⁰² See <http://www.business.gov/phases/launching/buy_franchise/franchising_overview.html> at 26 September 2006. This claim is so often repeated in franchise circles, including by academics, that it has become axiomatic.

³⁰³ <http://www.users.bigpond.com/warren13/in_australia.htm> at 31 March 2007.

³⁰⁴ Author unknown, 'Think Buying a Franchise is Safer than Starting a Business? Think Again' (December 2005/January 2006) *Fortune Small Business*.

franchisees.³⁰⁵ Blair and Lafontaine are the authors of the authoritative academic text on the economics of franchising, *The Economics of Franchising*. They conclude that the data available from various studies does not support the assertion that franchising is less risky than independent business, ‘the data contradict that investing in a franchise is a risk-free or very low-risk endeavour...failure rates suggest that joining a young or new franchise system is probably more risky than starting one’s own business.’³⁰⁶ This refutes one of the main advantages claimed by franchisors when marketing to prospective franchisees and by franchisees for buying franchises. This is one of the myths of franchising; franchisees entertain this and other fundamental misconceptions about franchising that lead to disappointment when the reality of franchising fails to match its promise.

The promise of franchising comprises other myths as well. The following comparison of industry association claims compared with the potential realities of the franchising experience underscores some of the common areas of franchisee misunderstanding. The following claims, in italics, are made on the Franchise Council of Australia website:

The Industry Association Claims³⁰⁷

(Industry Association claims are reproduced below in italics, followed by discussion of each claim after the heading, ‘Information the Industry Association does not provide’)

‘There are countless benefits to becoming a Franchisee, which is why Franchising is one of the fastest-growing sectors of the Australian economy. Here is a short list of eighteen advantages of Franchising over stand-alone forms of small business:’

Information the Industry Association does not provide: The initial premise here deserves closer examination. The FCA presents franchising as alternative to starting your own business. More research is needed to provide a better understanding of how franchising actually compares with independent small business ownership. According to Blair and Lafontaine, ‘In reality, owning a franchise is not at all the same as independent small business ownership.’ Blair and Lafontaine note a common

³⁰⁵ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 294. See also the ABA franchising listserv discussion of December 2005 that notes studies comparing success rates of independent small business and franchised businesses report conflicting results.

³⁰⁶ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 44.

³⁰⁷ See <<http://www.franchise.org.au/content/?id=185>> 26 September 2006.

misperception about the nature of franchising that is perpetuated by franchisor claims that this business structure provides the opportunity for a franchisee to ‘be your own boss’. They stress that a franchisee must see the arrangement as a contractual agreement of fixed duration. A franchisee is contracting for the right to use a particular trademark in a particular location for a particular time period; it should not see itself as establishing its own independent business that can be fully transferable. Franchising, therefore, is not comparable to independent small business ownership. This view is not cultivated by franchisors, however, because it would change the attitude of franchisees toward the enterprise, requiring different contractual and other devices to manage a franchisee.

‘1. The Franchisor provides detailed training.’

Information the Industry Association does not provide: This claim is true in some systems. The quality and extent of this training varies widely from system to system as do the costs that a franchisor charges to a franchisee for this service.

‘2. The Franchisee has the incentive of owning their (sic) own business with the additional benefit of continuing assistance from the Franchisor.’

Information the Industry Association does not provide: Again, the quality and extent of this assistance varies widely from system to system as do the costs that a franchisor charges to a franchisee for franchisor support.

‘3. The Franchisee benefits from operating under the name and reputation (brand image) of the Franchisor, which is already well established in the mind and eye of the public.’

Information the Industry Association does not provide: The franchisor’s trademark/brand is indeed important but the quality varies significantly. Not all brands are well-established, and it can be hard to quantify and ensure maintenance of the brand, as this is left to the discretion of the franchisor. Also, the franchisee may lose this benefit and be left without legal recourse in the case of franchisor sale of the system or insolvency.

‘4. The Franchisee will usually need less capital than they would if they were setting up a business independently because, through their pilot operations and buying power, will have eliminated unnecessary expense.’

Information the Industry Association does not provide: A franchisee may in fact need more capital than to set up an independent small business. It must pay the

franchise fee, its franchisor's as well as its own legal costs, and other upfront charges to a franchisor.

'5. The Franchisor provides the advice and/or help in identifying suitable trading locations or operating territories for the Franchisee.'

Information the Industry Association does not provide: A franchisee may benefit from such advice and/or help but its interests are not the same as those of a franchisor. (For examples of conflicts of interest between a franchisor and a franchisee see further discussion in this chapter and in Chapter Five).

'6. The Franchisor helps the Franchisee obtain occupation rights to the trading location, comply with planning (zoning) laws, prepare plans for layouts, shopfitting and refurbishment, and provide general assistance in calculating the correct level and mix of stock for the opening launch of the business.'

Information the Industry Association does not provide: Depending on the nature of the property rights in the premises and who holds them, a franchisor may provide these services, but will charge a fee, for example 25 percent of the total for franchisor management of shop fit-out.

'7. The Franchisor trains the Franchisee (and very often, the Franchisee's staff as well) in all areas of the business such as; manufacture, preparation, accounting, business controls, marketing, promotion and merchandising.'

Information the Industry Association does not provide: A franchisor may or may not offer these services. If so, a franchisor in most instances charges for them, usually at a profit to franchisor. The training of a franchisee and its staff can be a hidden expense, one not incurred in independent small business.

'8. The Franchisor may negotiate better rates of finance, or more favourable conditions, for Franchisees with financial institutions.'

Information the Industry Association does not provide: Anecdotal evidence from franchisees indicates that this may not be as easy or as beneficial to the interests of a franchisee as a franchisor might claim. There are also privacy issues; the franchisee may find that the franchisor is privy to information that the franchisee had disclosed only to its bank.³⁰⁸

'9. The Franchisee receives the benefit on a national scale (if appropriate) of the Franchisor's advertising and promotional activities at a lower cost than if they were to attempt such marketing themselves.'

³⁰⁸ Personal interview with Westpac franchise consultants suggest an interesting tripartite banking arrangement that may compromise a franchisee's confidentiality and increase a franchisee's and a franchisee's guarantors' vulnerability.

Information the Industry Association does not provide: This claim is true, but a franchisor has discretion to advertise and offer promotions that may cost the franchisee but may not benefit it or may even accrue to its detriment. (See discussion of advertising spending in Chapter Five.)

'10. The Franchisee taps into the bulk purchasing power and negotiating capacity made available by the Franchisor by reason of the size of the franchised network.'

Information the Industry Association does not provide: This claim is true, but there is also the risk that franchisor receives kickbacks from suppliers and other businesses in the franchisor's network. Again, this can add to a franchisee's cost.

'11. The Franchisee can call on the specialised and highly-skilled knowledge and experience of the Franchisor's head office organisation, while remaining self-employed in their business.'

Information the Industry Association does not provide: The accessibility and availability of assistance varies in different systems. This claim also raises the question of what it means to be 'self-employed' and still under the control of a franchisor.

'12. The support and benefits provided by a Franchise system greatly reduce a Franchisee's business risks.'

Information the Industry Association does not provide: Not proven, in fact Blair and Lafontaine assert that the opposite is often true in the case of new systems.³⁰⁹

'13. The Franchisee has the services of the field operational staff of the Franchisor who are there to assist with any problems which may arise from time to time in the course of business.'

Information the Industry Association does not provide: This claim is true, but here, too, the interests of a franchisor and a franchisee are different. The role of field staff is primarily to ensure compliance and franchisee productivity of the franchisee.

'14. The Franchisee has access to use of the Franchisor's patents, trade marks, copyrights, trade secrets, and any secret processes or formulae.'

Information the Industry Association does not provide: This claim is true; this is what a franchisee is essentially paying for, as Lafontaine points out, but only for the time specified in the contract at the unit premises. The franchisee needs to understand what it owns and what it can sell at the end.

³⁰⁹ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 44.

'15. The Franchisee has the benefit of the Franchisor's continuous research and development programs, which are designed to improve the business and keep it up-to-date and competitive.'

Information the Industry Association does not provide: This claim is true to the extent the system has such programs. But a franchisor and a franchisee have conflicting goals. Not all of a franchisor's new programs will benefit the franchisee.

'16. The Franchisor provides a knowledge base developed from their (sic) own experience, as well as that of all the Franchisees in the system, which would otherwise be impossible for a non-franchised business to access.'

Information the Industry Association does not provide: A franchisor has such knowledge, but is not required to provide it to the franchisee. A franchisee has no right of access to information about the franchise system in which it participates.

'17. Defined territories of operation within the Franchise can help protect the Franchisee from competition.'

Information the Industry Association does not provide: The franchisee may be protected from competition from other franchisees within the system, but not against franchisor encroachment or against competition from other competitors. A franchisee may be subject to contractual restraints while vulnerable to franchisor encroachment. Because the franchisee cannot trade outside its scope, but the franchisor can develop its business as it likes, the protection from competition accrues mostly to the franchisor. (See Chapter Five.)

'18. A Franchisee can always speak to their Franchisor or a fellow Franchisee to discuss their business challenges or problems - something a non-franchised business can almost never do.'

Information the Industry Association does not provide: This may be true, however, dissatisfied franchisees are often told that problems are their fault. They may be required to repeat training. They also may be threatened with defamation for communications with other franchisees, despite Code provisions that prohibit a franchisor from stopping franchisee association, and there is the potential of anti-trust violations if franchisees try to act collectively in a way that impacts a franchisor.³¹⁰

³¹⁰ For some discussion of the general nature of the issue, see Warren Pengilly, 'Trade associations and collective boycotts in Australia and New Zealand : a mistranslation of the Sherman Act down under', 32 *Antitrust Bulletin* 1019 (1987).

All of the above claims made by the franchisor trade association represent many of the reasons why franchisees buy franchise businesses. To summarize the motivations of a franchisee, franchising represents an opportunity to realize ideals such as autonomy, independence, material rewards, entrepreneurship, creativity, and flexibility, but with perceived levels of risk that are lower than starting a new business independently. In franchising, independence and autonomy coexist, though sometimes uneasily, with security and employment.

In a sense perhaps all franchisees are ‘lifestyle franchisees’ due to the strong intangible appeal of the lifestyle franchising seems to offer. This intangible appeal is an unquantified contributor to the success of franchising. It is also the source of conflict in the franchise relationship. A franchisee enters franchising for complex, often emotional reasons. Many of these reasons, though they are strenuously asserted by franchisors and repeated so often as to seem axiomatic, may not be supported by the facts. Myths that are commonly held about franchising lead to problems when reality fails to meet expectations. Misguided franchisee motivations are a source of misunderstanding about franchising and, ‘when expectations are set unrealistically, conflict almost invariably arises’³¹¹

3.4 INFORMATION ASYMMETRY IN FRANCHISING

A prospective franchisee needs information about franchising generally with respect to the structure, economics and performance of the sector. Because reliable information about franchising is not plentiful, however, it is difficult for a prospective franchisee to form an unbiased view of the nature of this business form and how the franchise sector operates. A recent survey of Australian franchisees asked, ‘Has the reality of owning a franchise lived up to the promise?’³¹² This survey pre-selected for positive responses, as it only included the most satisfied of franchisees, those still in business; former franchisees that had left the sector were not included in the survey.³¹³ Even so, the survey reported that 52 percent of franchisees believe that ‘the reality of

³¹¹ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 221-222.

³¹² The ‘promise’ is not defined by survey design; the mystery of what comprises the ‘promise’ of franchising persists.

³¹³ Forty-eight percent of those franchisees surveyed; the survey did not include failed franchisees that are no longer in operation.

owning a franchise has lived up to the promise.³¹⁴ For a slight majority of franchisees still operating, the survey suggests that their experience with franchising meets expectations. It is less encouraging that for almost half of franchisees still in operation it does not.

3.4.1 Reasons for lack of information about the sector

Misleading or deceptive conduct is a common complaint of franchisees.³¹⁵

‘franchisees say that the Disclosure Provisions do not prevent a franchisor from including misleading information in their disclosure documents. In particular, franchisees have raised concerns that franchisors misrepresent profit expectations, the viability of a franchise and the level of work required for the franchise to be successful. While the provisions of the TPA prohibit such misleading conduct, franchisees claim that if such behaviour does take place, it is too expensive and time consuming for them to take action against the franchisor, and some accuse the Australian Competition and Consumer Cooperation (ACCC) of failing to take timely steps to prosecute the franchisors on their behalf.’³¹⁶

Litigation involving misleading or deceptive conduct is discussed further *infra* at 3.4.1.5.

Franchising is a significant sector of the Australian economy, but the scarcity of reliable information about the franchise sector impedes useful discussion and analysis of the operation of the sector, creates uncertainty for a franchisee, and contributes to an imbalance of power in the franchise relationship.

There are five principal reasons for the lack of balanced, reliable and accurate information about franchising. The first and most fundamental is that the sources of information about the sector are limited and the available information is dominated by franchisors’ interests. Second, franchisors are selling the franchise product and so have a strong interest in projecting a positive image of the sector. Third, not only at

³¹⁴ The study report does not list the range of responses to this question, nor is it known how the franchisees were chosen who participated in this franchisor-funded survey.

³¹⁵ As indicators of the high level of franchisee concern/complaint in Australia in the area of misleading or deceptive conduct see information provided by the Australian Competition and Consumer Commission, FCA surveys and keywords in litigation in the franchise sector. In a sample of ‘matters the ACCC has pursued since 2004 Outcomes’ 7 of 11 list misleading or deceptive conduct is an element of over half. See the ACCC release on ‘Franchising Complaints, Investigations and at <http://www.accc.gov.au/content/index.phtml/tag/franchisinginvestigations/> 24 January 2008.

³¹⁶ See Price Waterhouse Coopers Legal ‘Australian Government reviews the Franchising Code of Conduct’ at <http://www.pwclegal.com.au/legal/pwclegal.nsf/pages/FDDC77FC52668E2DCA2572100007F54D> at 24 January 2008.

the beginning, but throughout the relationship, franchisors and franchisees have conflicting interests, and so do not readily share information as readily as an outside observer might expect. Fourth, defamation and competition law are both of concern for franchisees that may wish to communicate to others their experiences with franchising. Fifth, it is difficult to garner evidence from dispute processes. Because mediation, the Code-mandated dispute resolution procedure, is a confidential process, no information is available to those outside the dispute. Each of these factors is explained in more detail in the following sections.

3.4.1.1 Franchisor interests dominate limited sources of information

Past reports such as the Gardini and Reid Reports no longer reflect the state of play in the mandatory Code era since 1998. Most statistics about franchising in Australia have been generated by studies funded either directly or indirectly by franchisor organizations or interests. The Franchise Council of Australia (the FCA) is the only active industry group in Australia. It consists almost entirely of franchisors.³¹⁷ When a franchise system joins the FCA, the franchisor becomes a member but the system's franchisees do not also become members.³¹⁸ Most franchisees do not join on their own because membership is expensive and franchisees do not perceive sufficient benefit for the high cost of membership.

In Australia the bi-annual FCA surveys are essentially the only source of empirical data about the sector. These surveys are funded by the FCA, allowing the organization to play a major role in framing the questions. As most of the respondents are drawn from FCA membership, the surveys tend to represent the point of view of only one side of the sector's participants. When an FCA survey reports that the existing regulatory scheme is working well, one must ask whether it is working well from all perspectives. Perhaps it is working well from the point of view of franchisors, as they represent the majority of survey respondents. Or perhaps the favourable response is due to franchisors' desire to avoid incurring further outside scrutiny of the sector and further regulatory intervention.

³¹⁷ The franchisees that are members are often the franchisees who are also franchisors; whose membership is predominantly connected with the latter role.

³¹⁸ Some associations operate on a different model, for example when a franchisor joins the French Franchise Federation, its franchisees do automatically become members.

Surveys not directly funded by the FCA suffer from the similar deficiencies. A recent survey of franchisee satisfaction, the 2004 Deloitte ‘Franchisee Satisfaction Survey’, in fact contains no information with respect to reasons for franchisee satisfaction or lack thereof, and no information about conflict within the sector. There are no questions with respect to problems encountered by franchisees, though such information is critical to a comprehensive understanding of franchisee satisfaction and of the health of the sector. The nature of the survey instead displays the qualities of a marketing initiative rather than an information-gathering exercise, but this is not surprising as the Deloitte survey, though not directly funded by the FCA, was commissioned and carried out in part by the firms of board members of the FCA.³¹⁹

Some franchisee associations in the US and elsewhere and websites representing franchisee viewpoints offer another side to the story.³²⁰ While the American Franchise Association³²¹ and the American Association of Franchisees and Dealers offer advice and support for franchisees, there is at this time no similar service or support available to franchisees in Australia. There have been attempts to set up state and national franchisee industry groups, but such groups have not been successful. The most recent attempt to organize franchisees in Australia, the Australian Franchisees Association Incorporated had little funding at its inception and is now defunct. In Australia such organizations have never attained a level of stability or success to allow them to gather or provide information about the sector from a franchisee point of view.

3.4.1.2 Franchisors must project a positive image to make the sale

As in the US, so too in Australia, ‘[t]he franchise industry has been relatively successful in keeping from the public and legislators the true nature of what goes on

³¹⁹ Deloitte Touche Tohmatsu, *Franchisee Satisfaction Survey Benchmark 2004*, <http://www.deloitte.com/dtt/cda/doc/content/franchise_survey_lo-res.pdf> at 29 December 2005. Alan Branch, a partner at of Donaldson Walsh Lawyers, one of the firms responsible for the survey is also a director of the FCA.

³²⁰ See, for example, <<http://www.ripoffmerchant.net/>> at 18 March 2004, <<http://www.licenceenews.com/ethics1.html>> at 15 March 2007, and <<http://www.toastedsubs.info/>> at 15 March 2007 and <<http://www.QuiznosSucks.com/>> at 18 March 2004.

³²¹ See the American Franchise Association (AFA) <<http://www.franchisee.org/>>, a Franchisee Voice <<http://www.aafd.org/publications/franchisevoice/>> and the American Association of Franchisees and Dealers <<http://www.aafd.org/>> respectively.

in franchising...’³²² Franchisors’ interest in the dissemination of only the sunnier aspects of the sector is due not only to their motivation to avoid further scrutiny and intervention by regulators, but also, and perhaps more importantly, to their interest in marketing franchising to potential franchisees. This interest prevails over the need to analyse the sector through an objective lens in order to ensure and improve the quality of franchising generally.

Franchisors have a collective interest in promoting the franchise product. A supply of new franchisees is the ‘life blood’ of franchise systems, so it follows that franchisors want to stifle news of conflict or of unsuccessful franchisees.³²³ The Deloitte 2004 ‘Franchisee Satisfaction Survey’ notes that 25 percent of franchises have been owned for one year or less, and that ‘Extraordinarily, close to two-thirds of franchises have been owned five years or less.’³²⁴ The survey attributes this figure to ‘an extended growth phase’ which it does not explain.³²⁵ Surveys show growth to be steady at about thirteen percent per year.³²⁶ If a quarter of franchises have been owned for under a year, two-thirds less than five years, these figures must be explained by factors other than thirteen percent annual growth. The obvious answer would be high turnover of franchisees. As there has been no research on franchisee failure rates in Australia, there is no data to resolve this question.

When one considers that franchise fees are a principal source of revenue for many franchise systems, it is perhaps not surprising that two-thirds of franchises have been owned for less than five years. High turnover can be profitable for franchisors. Marketing the franchise as a product to prospective franchisees is uppermost in franchisors’ minds. Exploring and publicising the difficulties that may arise in the course of the relationship is not.

³²² Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn St. Law Review* 105, 316.

³²³ Personal interview with Lorelle Frazer, Professor of Marketing, Griffith Business School, Logan campus (March 2004).

³²⁴ Deloitte Touche Tohmatsu, *Franchisee Satisfaction Survey Benchmark 2004*, Item 7 <http://www.deloitte.com/dtt/cda/doc/content/franchise_survey_lo-res.pdf> at 29 December 2005.

³²⁵ *Ibid.*

³²⁶ Lorelle Frazer, Scott Weaven and Owen Wright, *Franchising Australia 2006 Survey*, Franchise Council of Australia Survey, Griffith University and the Franchise Council of Australia Ltd., <<http://www.franchise.org.au/content/?id=182>> at 14 September 2007.

3.4.1.3 Franchisor and franchisee conflicts of interest

Different conditions lead to different stresses and strains on the relationship at different stages in its progress, and that the character of the relationship varies with the stage of operation of both the individual franchise unit and the system, in addition to external influences. There are several stages of a franchise system's operation; these might be arranged chronologically as system development, recruitment, negotiation, unit start-up, adolescence, maturity, exit and post-termination. As they impact on information exchange and the availability of information, the first six of these are introduced briefly here. Exit and post-termination issues will be discussed further in Chapter Five.

System development: In the academic literature system development is not a commonly identified stage in the franchise relationship. It is important, however, because of its formative influence on the relation. Typically, a franchisor develops a franchise system, and assumes the business risk in the development of pilot stores, company-owned stores and the system as a whole. A franchisor invests time, money and effort in formulating, developing, testing and marketing the franchise concept and system. If a franchisor invests sufficient resources in the development of the system, the product is more likely to be satisfactory to a franchisee and less susceptible to problems as the relationship between franchisor and franchisee develops in later stages. The system development stage underscores the fact that a franchisor bears the risk of system failure, and also that a franchisor has control over the system and knowledge that is superior to that of a franchisee.

Recruitment: Also not a commonly identified stage, it is included here because interviews with franchisors indicate that they consider the selection of franchisees a critical factor in the success of the system. The nature of the recruitment of franchisees varies depending on market and demographic conditions. One of the problems franchisors face in Australia is a shortage of qualified franchisees, 'The main constraint we are facing is a shortage of good franchisees.'³²⁷ Because a franchisor is less vulnerable to each single unit failure than is the individual franchisee operating that unit, a franchisor bears less risk of poor selection than a franchisee.

³²⁷ Richard Evans, CEO of the FCA quoted in Derek Parker, 'Franchising', *The Australian*, (Sydney) 30 June 2006. See also Lorelle Frazer and Scott Weaven, *FCA Franchise Survey 2004* (2004) Griffith University and the Franchise Council of Australia <<http://www.franchise.org.au/content/?id=198>> at 15 July 2007.

Apart from the risk to a franchisor's reputation, a franchisor's risk is contained because the franchise fee is designed to cover a franchisor's costs of establishing the new franchise unit. If qualified franchisees are in short supply, franchisors may be tempted to accept franchisees lacking the proper qualifications to make a success of the business,³²⁸ and may fail to adequately screen and select franchisees. Information exchange is critical at this stage, but may not be as candid as it should be, as each party seeks to make the best impression possible in order to meet its market requirements as well as to secure a strong bargaining position in the subsequent negotiation stage.

Negotiation: A franchisor holds the power in franchise negotiations; it is a franchisor's business and it is a franchisor that draws up the contract and writes the operations manual (the OM). A franchisor has both the opportunity and the responsibility to set the tone of the relationship; as will be discussed in Chapter Four, a franchisor used this opportunity to establish its authority and control in the interests of system uniformity. A franchisor firmly establishes its power in the relationship at this stage by presenting the terms of the contract as drafted by the franchisor with no possibility of negotiation. This is not a time for the exchange of information about parties' positions and needs.

Unit start-up: Analyses of the relationship in marketing and management literature typically start with this stage, which consists roughly of approximately the first six months to the first year of unit operation. Just as a franchisor usually makes a major investment in developing the system, a franchisee also makes a large up-front investment, in time and effort as well as money at the start-up of a new unit. The average investment at start-up for a new franchisee in Australia is \$85,000, but a required investment of \$785,000 to \$1 million is not uncommon to buy into the better-known brands and best-performing franchise systems.³²⁹

Franchising involves the exchange of the information and expertise of a franchisor for the entrepreneurial effort of a franchisee. The gap between expertise and enthusiasm is most pronounced at start-up and in the early years a franchisor has the greater levels

³²⁸ For studies correlating qualities of franchisees with success of the franchise please refer to <<http://www.franchiserelationships.com>> at 30 December 2005.

³²⁹ *What a Quiznos Franchisee Makes* (2005) Franchise Pundit <<http://franchisepundit.com/index.php/2005/04/10/what-a-quiznos-franchisee-makes>> at April 10, 2005.

of know-how and control. A franchisor often provides a franchisee with training, guidance, information, reassurance and psychological support. Franchisor support at start-up is therefore considered an important factor in avoiding future problems. This role means that a franchisor enjoys considerable influence over a franchisee.

Adolescence: This stage involves extends roughly from middle to late in the first year into the second or third depending on the system. At this stage a franchisee becomes more comfortable with the operation of the franchise. Having gained experience and information which in many respects may surpass that of a franchisor, a franchisee becomes more confident in asserting ideas and opinions. This increased confidence may reduce a franchisee's dependence upon a franchisor; a franchisee may even feel strong enough to challenge a franchisor. It is around this time that a franchisee senses that he understands the market and the business at a local level better than a franchisor. In addition, he may be frustrated that his innovations cannot be easily implemented, if at all. Information flows in the direction of a franchisee to a franchisor may become more important at this stage. Also, the focus of a franchisor contribution to the relationship may shift from training and support to a franchisor's role in coordination of the franchise system and the services provided in that context, most importantly brand maintenance.³³⁰ A franchisee continues to pay the costs of the franchise but this may be with a decreasing appreciation of the benefits of the relationship. Here a franchisor may rely more on the contract, field visits and other means to ensure control.

Maturity: This stage extends from mid to late in the second or third year to the end of the term. The 'growing pains' of adolescence often level off as the franchise unit matures; the relationship may enjoy a relatively harmonious and profitable period. As at any stage, however, the relationship is threatened by a range of issues with disruptive potential. Franchisee-driven pressures may arise from any of a number of sources of stress and challenge, even unexpected levels of franchisee success. Franchisor-driven pressures occur when a franchisor introduces new products and services, marketing initiatives,³³¹ distribution channels, or plant and equipment.³³²

³³⁰ Phillip Phan, John Butler and Soo Lee, 'Crossing Mother: Entrepreneur-Franchisees' Attempts to Reduce Franchisor Influence' (1996) 11 *Journal of Business Venturing*, 370, 402.

³³¹ These are external, but to a greater or lesser degree are a recognition of, and response to, new customers and markets.

Pressures on franchising systems may also be external, caused by demographic, technological, legal, or supply chain changes.³³³

There are many potential conflicts of interest in the operation of the franchise. A master franchisor wants to maximize system revenue, while a master franchisee will want to maximize territory or unit revenue and a franchisee wants the best unit profits.³³⁴ A franchisor seeks growth in sales, while for a franchisee sales growth may be undesirable if it comes at the expense of profits. Also in relation to profits, a franchisee may want to skim off profits while a franchisor wants them reinvested, for example in capital assets and local advertising. General conflicts of interest include the following:

- A franchisor wants control; a franchisee wants independence and autonomy.
- Franchisor interest in uniformity and strength of trademark against franchisee interest in managerial autonomy.
- A franchisor's roles as administrator and supplier conflict with its other roles such as that of partner and trainer.
- A franchisor may be maintaining relationships with investors while a franchisee has to contend with employees.
- A franchisor must guard against franchisee free-riding, while a franchisee must guard against franchisor opportunism.

Related to many of these conflicts is information-sharing. Both sides will be tempted to withhold information for their own advantage. For example, at the start of the relationship a franchisor may be selective in information he chooses to disclose to a franchisee. Later, a franchisor may not share future business plans including expansion and marketing plans. A franchisee on the other hand, may not give accurate accounts business results or market conditions.

³³² International Institute for the Unification of Private Law (UNIDROIT), *UNIDROIT Guide To International Master Franchise Arrangements* (1998) above n 26 at 145-146. The UNIDROIT Guide does not address the issue of franchisee initiated disputes such as those reported by OMA and the 2002 Survey, perhaps because franchisees are seen as reacting to rather than initiating change.

³³³ For a discussion of the problems encountered in the course of the franchisor/franchisee relationship, through the terms of the contract please refer to Chapter 5

³³⁴ B. Elango and Vance H. Fried, 'Franchising Research: A Literature Review and Synthesis' (1997) 35(3) *Journal of Small Business Management* 68, 73.

Throughout the relationship, conflicts of interest mean that franchisors and franchisees do not share information. This is a particular problem for a franchisee, because, while a franchisor generally has the right to access all of a franchisee's information about its business (see Chapter Five, Minimum Performance and Reporting Requirements), the reverse is not the case. A franchisor has full information and control over that information, but a franchisee must rely on a franchisor to provide whatever information a franchisor wants a franchisee to have. The difficulty that is encountered by franchisees in uncovering information sets up heightened uncertainty for a franchisee entering a franchise relationship. And because a franchisor exercises control over much of this information, there is an imbalance of power in favour of a franchisor.

3.4.1.4 Risk of defamation, breach of confidentiality and competition law

The fourth reason for the lack of information about the sector is that franchisee communications are chilled by the perceived risk of defamation. In early May 2006 a group of Lenard's franchisees visited the Office of the Minister for Small Business in Canberra to discuss problems common to franchisees in that franchise system.³³⁵ Several of these franchisees had been threatened by a franchisor with defamation suits. In New Zealand a franchisee of Dymock's, an Australian franchise system, was found to have shown a lack of good faith in contacting other franchisees about its dissatisfaction with the system, despite the fact that he did so with the franchisor's express permission.³³⁶ The Franchising Code states that, 'a franchisor must not induce a franchisee not to form an association or not to associate with other franchisees for a lawful purpose.'³³⁷ There is no guarantee, however, that franchisees who associate to discuss topics other than how delighted they are with the system will not be threatened with defamation proceedings or found to have breached the agreement though a lack of good faith. Franchisees also are often required to sign confidentiality agreements that prevent them from communicating with other franchisees; if they do they risk breach of the contract. Not only do they risk action by a franchisor, but there is the added risk that they may find themselves in breach of

³³⁵ These franchisees were advised by the Minister's office to take their concerns to the Franchise Council of Australia for assistance.

³³⁶ *Dymocks Franchise Systems (NSW) Pty Ltd v Todd and Others* [2002] UKPC 50.

³³⁷ *Franchising Code of Conduct* s15 Association of franchisees: A franchisor must not induce a franchisee not to form an association or not to associate with other franchisees for a lawful purpose.

the competition law provisions of the Trade Practices Act (the TPA). Few franchisees have the resources and the time to take on the risk of defending an action for defamation or breach of competition law; they are by nature risk-averse, their perception of franchising as low-risk is one of the reasons they enter franchising in the first place. Most prefer to keep quiet.³³⁸

3.4.1.5 Scarcity of information from conflict resolution processes

Because conflicts arise more frequently when there are problems with the operation and/or profitability, the incidence of conflict in the sector can provide a valuable barometer of the success of the relationship. Generally speaking, information about litigation and other forms of dispute resolution can be useful in shedding light on the problems in a sector or industry, or type of relationship. Dispute resolution in Australia, however, yields relatively little useful information. The fundamental problems are that mediation is mandated by the Code, that there are problems with getting information through and about mediation; that because mediation is mandated there is less case law; and, finally, that the case law that is available is often not very instructive. There is little that has been done to remedy the situation, however, because the correlation between incidence of conflict and issues about the success and profitability of franchising, however, again leads to reluctance on the part of industry leaders to explore the reasons for conflict in the sector.

According to Part IV of the Code all post-Code franchise contracts must provide that if one party to a dispute requests mediation the other must attend. Mediation has advantages, but providing information about the sector is not one of them. The mediation procedure prescribed by the Code is opaque; the results are confidential. As parties' resort to mediation in the franchising sector grows, therefore, the information available to guide parties in subsequent instances of similar disputes is decreasingly available.³³⁹ The reliance on mediation thus compounds the difficulty in tracking levels and trends in conflict.

³³⁸ Gillian K. Hadfield, Expert Testimony , Legislative Assembly of Ontario, March 8, 2000 <http://www.blumaumau.org/gillian_hadfield_value_reputation_systems> at 9 September 2007. Hadfield testified to the Ontario [Canada] public hearings on the regulation of franchising in 2000, '...there should be a real push for the government to make sure that information is flowing, that it's not made confidential by confidentiality agreements, that franchisees are protected against lawsuits in the event they talk about what's happened to them as franchisees.'

³³⁹ In *The Silver Fox Company Pty Ltd as Trustee for the Baker Family Trust v Lenard's Pty Ltd (No 3)* [2004] FCA 1570 (Mansfield J) however , even though parties to mediation had agreed that any

The confidentiality of the mediation process disadvantages franchisees far more than it does franchisors. A franchisor may be in a number of disputes with its franchisees and so has the knowledge and experience of each dispute, including how it may have been settled, what payments and concessions may have been made and so on. An individual franchisee has no such experience with the mediation process or the issues involved; further, a franchisee is not privy to information about how similar disputes may have been resolved. There is also an issue of disparity in legal representation, discussed in more detail in Chapters Four and Six.

One of the key recommendations of the Review of the Code was to urge a full report on mediation,³⁴⁰ but to date no such a report has been undertaken; or if it has, it has not been made public. It is also worth noting that a franchisor is not required to provide information about mediation proceedings to prospective franchisees, despite the fact that mediation is the Code-mandated dispute resolution procedure.

The FCA reports that in Australia ‘the current statistics are that well over 70% of all mediations are successful.’³⁴¹ The following figures collected for this research, however, suggest a slightly different story:

- Between its establishment in late 1998 and the collection of this information in the first quarter of 2004, the Office of the Mediation Adviser (OMA) had received 1078 dispute enquiries. Of these inquiries only about one-third proceed to mediation; in total OMA had appointed mediators for 308 mediations (roughly 70 per year since its inception in 1998);
- About ten percent of these disputes settled after the appointment of a mediator but before proceeding to mediation; and
- Of the disputes that were mediated, just over 62 percent resulted in settlement.³⁴²

settlement proposal would be “privileged” and would not be tendered as evidence in any proceedings, the Court decided that evidence of the settlement proposals at mediation was admissible for purposes of the applicants' claim for indemnity costs.

³⁴⁰ See Department of Industry, Tourism and Resources for links to report: <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?ObjectID=21E67F0D-0639-4616-B4E1432B70363C13>> at 11 April 2007.

³⁴¹ Letter from FCA Chairman Stephen Giles to American Bar Association Forum on Franchising listserv posted 05/04/06.

³⁴² Figures provided by the Office of the Mediation Adviser (2004).

Of those disputes that proceeded to the appointment of a mediator, the settlement rate is indeed high, about 72 percent. Only 30 percent of all inquiries were referred to mediation, however, which means that in fact only about 20-25 percent of all inquiries to OMA achieved resolution through the mediation process. This means that about 75-80 percent of the conflicts that were serious enough to prompt a contact with OMA were not resolved through the mediation process, and, perhaps what is most significant, there is no data at all about the disposition of those disputes.³⁴³

Case law as an avenue for the collection of accurate information about conflict in franchising is not very informative. This is in part due to the fact that many franchise disputes are settled through mediation. A 2001 study noted that,

‘Soft law can... hinder the development of case law... if a code represents consumer protection in an area where the ‘real’ law is inadequate or incomplete, there is a need for consumers and their advisers to see how those who apply the code use it and develop its principles. Flexibility is another advantage often boasted for soft law, but if there is no transparency in how it is being applied, there is no scope for flexible development.’³⁴⁴

Where franchising cases are litigated, the results are public and provide a potentially valuable source of information. Even so, litigation may be a poor information source for several reasons. One reason is that the diversity of state laws applicable to franchising impedes the formation of uniform precedent. The New South Wales (NSW) Industrial Relations Act (1996), for example, has provisions upon which Courts may rely such as s84 regarding employment, and s106 regarding misrepresentation.³⁴⁵ In Queensland (QLD) there is no such legislation and similar cases rely on the TPA section 52, the Code and the contract. There are also different state interpretations of, for example, the duty of good faith. A further reason information is hard to glean from litigation is that franchise cases usually involve multiple issues, some of which may not relate specifically to the franchise sector, for example leases, unconscionable conduct, restraint of trade, and misrepresentation. These issues are determined by non-franchise specific laws and principles. Finally, the results of litigation are fickle; especially where the number of cases is small and

³⁴³ The FCA also makes the claim that ‘As a result of the regulatory regime the level of "substantial disputes" in franchising is around 1.8 percent and falling. The report of a declining rate of disputes is based on a survey of franchisors who, for reasons already described, wish to avoid the appearance of problems in the sector.

³⁴⁴ From ‘Soft Law and the Consumer Interest’, *European Consumer Law Group*, ECLG/071/2001 - March 2001 <http://ec.europa.eu/consumers/policy/eclg/rep03_en.pdf> at 22 May 2007.

³⁴⁵ See <http://www.austlii.edu.au/au/legis/nswwithconsol_act/ira1996242/> at 11 April 2007.

where reliable information about the sector and the franchising relationship to inform judges' decisions is difficult to obtain.

The nature of litigation does, however, provide some clues as to the problems and sources of conflict in franchising. Misleading or deceptive conduct under section 52 of the Trade Practices Act is a frequently litigated complaint in franchising in Australia.³⁴⁶ In *Australian Billboard Connections Pty. Ltd v Jansen*³⁴⁷ it was determined that the franchisor must not estimate a prospective franchisee's earnings without stating assumptions and that it should not disclose cash flow of other franchisees without giving details of franchisees in the same state as well as any other information which could affect that franchisee's earning capacity. In *ACCC v Billbusters*³⁴⁸ a Federal Court granted summary judgment declaring that a director was knowingly concerned in, or party to contraventions of misleading and deceptive conduct provisions of the TPA.³⁴⁹ In *ACCC v Ewing*³⁵⁰ the court considered whether licence agreements were really franchise agreements. The court held that the franchisor had engaged in unconscionable conduct and misleading or deceptive conduct in failing to disclose all documents. In 2006 proceedings against *Photo Safe Australia Pty Ltd* the Federal Court declared that the managing director misled and deceived 37 small business investors in several ways, including failing to provide franchisees with disclosure documents and other information required under the Code.³⁵¹ In *Poulet Frais v The Silver Fox Company*,³⁵² however, agency principles

³⁴⁶ Post-Code cases are outlined here in the text. Pre-Code cases include *Pre –Code cases on misleading or deceptive conduct include ACCC v Ewing* [2004] 2204 FCA 5; *O'Dea v Casnot* (1980); *Bateman and Another v Slatyer and Others* (1987) Fed Ct of Aust (Barbara's House & Garden); *Ducret v. Colourshot* [1981]; *Crawford v Parish* (1991) 105 FLR 361; [1991] ACTSC 87 (18 October 1991); *Novamaze Pty Ltd v Cut Price Deli and Others* (1995); *Haynes & Anor v Top Slice Deli* (1995); *Maiden & Ors v NZ Natl Pty Ltd* (97). For a summary of ACCC litigation and undertakings from 2002 to 2006 taken from ACCC annual reports see http://www.pc.gov.au/_data/assets/file/0006/71286/sub083attachmentb.rtf

³⁴⁷ *Australian Billboard Connections Pty. Ltd v Jansen* [2000] VSC 471

³⁴⁸ *ACCC v Billbusters* [2003] FCA 423.

³⁴⁹ See <http://www.accc.gov.au/content/index.phtml/itemId/347410> at 24 January 2008. See also the Armour Linings undertaking.

³⁵⁰ *ACCC v Ewing* [2004] FCA 5.

³⁵¹ See <http://www.pwclegal.com.au/legal/pwclegal.nsf/pages/FDDC77FC52668E2DCA2572100007F54D> at 24 January 2008. See also <http://www.accc.gov.au/content/index.phtml/itemId/687893/fromItemId/761521> at 24 January 2008. Other misleading or deceptive conduct cases since the introduction of the Code include *ACCC v Global Prepaid Communications Pty Ltd* (ACN 095 154 108) (in liquidation) [2006] FCA 146; *O'Connor v*

applied to allow a franchisor to avoid liability for the misleading or deceptive conduct of a sales agent. This sampling of the cases litigated since the adoption of the Code illustrates the nature of claims of breach of TPA section 52 in franchising which typically involve franchisors' or franchisors' agents' representations that fail to materialize regarding earnings, payments and costs, advertising, lead generation and franchisor support. Franchisees have in some cases been able to recover payments, court costs, and also part payment of ACCC costs.

This pattern of litigation seems to prove at least one thing for certain; getting accurate and reliable information about franchising is a problem for franchisees. Though it is not clear whether the Code has impacted on the frequency of complaints of misleading or deceptive conduct, sources at the ACCC have reported an increase in disputes in franchising involving misleading or deceptive conduct, especially about anticipated earnings and territorial issues.³⁵³

3.4.1.6 Summary of limitations on information about franchising

A similar information problem was identified in the franchise sector in the US over fifteen years ago. In its 1990 report on 'Franchising in the US Economy' the House of Representatives Committee on Small Business noted: 'Despite its growing significance, there is a surprising lack of comprehensive and accurate information concerning all aspects of franchising nationally.' At that time there had been a number of statistical reports. The limitations of such reports, however, were noted by the Educational Foundation of the International Franchising Association (the IFA) in its 1998 'Profile of Franchising':

'For years, those in franchising and those studying it have desired reliable data on the realities of franchising as seen in the business community. Until now, most attempts at such an overview have been based on survey results and, as all researchers know, the return rates on surveys tend to be discouragingly low.... Moreover, some felt that the picture painted by such survey returns was misleadingly positive because those having business difficulties would be less likely to take the time to complete and return surveys.'³⁵⁴

Roadrunner Mobile Video Pty Ltd [2006] FMCA 150; *ACCC v Will Writers Guild Pty Ltd* [2003] FCA 1231; and *ACCC v 4WD Systems Pty Ltd* (2003) 200 ALR 491).

³⁵² *Poulet Frais v The Silver Fox Company* [2005] FCAFC 131.

³⁵³ Martin, John, Commissioner, *The Health of Franchising from the Viewpoint of its Regulator*, Address to the Franchising Council of Australia, 23 October 2001.

³⁵⁴ 'Deacons on franchise legislation', <<http://www.franchisebusiness.com.au/articles/>>, 14 March 2006.

The net effect is that it is not always clear how the different interests in the franchising relationship manifest themselves and why; what the risks are for the participants in the sector; and what aspects of problems encountered in the sector could best be addressed through what types of regulatory intervention. Experience shows that relationships are extremely difficult for those outside them to assess. The commercial relationship in franchising is no exception. The phrase, 'the private is public for those for whom the personal is political'³⁵⁵ could be restated for franchising as 'the private is public for those for whom the commercial relationship is political'.

The commercial relationship is political because issues within the franchise relationship impact the business community as well as economies both domestically and globally. The franchise relationship is not strictly a private one between franchisor and franchisee. Though some franchisors may feel threatened by greater scrutiny, ultimately, the continued success of the sector depends on an accurate understanding of this relationship to inform its development, including its regulation. Answers are sorely needed to questions about the problems in franchising and about which problems are most significant to each of the parties at which stages in the relationship. As long as information about the relation is kept private, or is controlled by only one side of the relation, the nature of the dynamic will continue to elude outsiders. Disclosure as a regulatory tool makes sense, but as will be outlined in later chapters, in the context of the franchise sector in Australia it is not effective. More importantly, as Chapter Six will explain, disclosure about particular franchise systems to franchisees as consumers is no substitute for the data that is urgently needed to inform regulatory process. More meaningful measurements of the performance of the sector and the impact of regulation upon it are critical to any future regulatory initiatives.

The 2006 Review acknowledged the problems of lack of franchisee awareness of the risks involved in franchising. The Review Item 3 recommended a requirement of franchisors to include a Risk Statement with the disclosure document. This was not agreed to by the government. Its statement, 'Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses

³⁵⁵ 'The Personal is Political' is a phrase from the New Left, a slogan of the old Students for a Democratic Society. Dating back to at least 1964, it is thought to have been inspired by C. Wright Mill's 1959 book, "The Sociological Imagination." See <http://research.umbecause.edu/~korenman/wmst/pisp.html> accessed 29 June 2006.

themselves,' seems to undermine the theoretical basis for the choice of disclosure as a principal tool of regulatory intervention in franchising.³⁵⁶

3.5 CHAPTER CONCLUSION

Chapter Three's introduction to the sector establishes a foundation for the balance of the dissertation by explaining the self-regulation of the relationship by means of the market, by providing context for the analysis of contract and by explaining the information asymmetry that sets up conditions of imbalance of power and uncertainty that regulation is meant to address.

The self-regulation of the relationship by means of the market interaction is the first topic of the chapter. Franchising is a complex, multi-faceted and dynamic organizational form. Though there is little consensus about the legal definition of franchising, at its essence franchising allows a franchisor to sell rights to its intellectual property while at the same time keeping strict control over the use of that intellectual property in order to maximize brand value. A franchisor's reasons to franchise are primarily economic. The choice to franchise addresses problems of capital inefficiency and contains transaction costs. Franchisors understand the nature of franchising; they know why they are there and often obtain extensive professional advice.

A franchisor presents the licence to participate in a franchise system as a product to a franchisee as a consumer. In addition to the dimensions of a franchisee's role as, variously, investor, employee, and partner, a franchisee's role as consumer tends to involve power imbalance and greater control to a franchisor. Franchisee reasons to franchise are less tangible, more complex, and arguably less rational than the reasons a franchisor chooses to franchise. They are based on perceptions of economic benefits of franchising, despite the fact that these benefits are in many cases unproven. A franchisee choice is also based on perceptions of personal and lifestyle benefits.

This dissertation argues that a franchisee choice to franchise must necessarily be based less on fact because accurate, reliable data about the sector and about individual

³⁵⁶ See the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007 and the Australian Government *Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

franchise systems is difficult to obtain. Significant gaps remain in the body of knowledge about the sector generally and knowledge about the sector in Australia,³⁵⁷ Further, despite disclosure, prospective franchisees often lack information, not only the sector but also about the nature of the particular enterprise. (This is discussed in detail in Chapter Six)

The franchising form is selected by a franchisor, to serve its objectives. Thus, the self-regulation of the franchising relationship by means of the market tends to serve the interests of only one side of the relationship, that of a franchisor; it does not equally serve the interests of both franchisor and franchisee. Market forces establish conditions of imbalance of power and uncertainty for a franchisee in this business relationship. A franchisor has the knowledge, selects this business structure to suit its purposes, and markets the structure to prospective franchisees. A franchisor wants to sell franchises; the information provided by franchisors and franchisor associations therefore is biased and, with no registration or monitoring, may be unreliable. Though one might expect the situation to be better for franchisees in a ‘sellers’ market’ where, as in Australia, qualified franchisees are in short supply, the increased intensity of marketing efforts by franchisors may actually exacerbate the problems of obtaining reliable information. The market regulation of the franchise relationship indicates a strong tendency toward power imbalance in favour of a franchisor and high levels of uncertainty for a franchisee. To the extent that knowledge is power, a franchisor has significantly greater power than franchisees.

Reducing the mythology of franchising can help re-balance the power in the relationship and to reduce uncertainty for franchisees. In making the decision to franchise a franchisee as a consumer of the franchise product should understand that product, it should understand what franchising is, what purposes it serves both parties and the nature of the contract and the relationship as well as details about the particular system. In principle a franchisor would want to attract franchisees who are knowledgeable and who understand the nature of this business structure before agreeing to participate, in order to save on the costs associated with misunderstandings, such as monitoring and conflict management during the course of the relationship.

³⁵⁷ There are bi-annual franchisor surveys and a growing body of data, but not enough data to support or refute the efficacy of regulation.

Regulatory intervention is often used to address inefficiencies and inequities in market interaction. The lack of information about franchising makes disclosure seem the perfect solution. The use of disclosure, however, may not be effective, as will be discussed in Chapter Six. Regulatory process requires meaningful measurements. Regulation of franchising is missing this first essential element of process; the result is that the regulatory program lacks accountability and a solid justification. Chapter Three lays the groundwork for this discussion in Chapter Six by explaining the lack of information generally and also the information asymmetries within the franchise relationship.

Before proceeding to a detailed analysis of the use of disclosure in regulating franchising, however, the next two chapters consider further the private regulation of the relationship by the parties, specifically through the instrument of contract. Chapters Four and Five assess how the regulation of franchising through contract as a layer of governance reflects and serves the interests of participants. They also discuss whether the private regulation through the contract achieves the stated goals of regulatory intervention that are tested in this thesis, balance of power and certainty.

3.6 CHAPTER SUMMARY AND RECOMMENDATIONS

Chapter Three provides an introduction to the sector; it explains the market interaction as a means of private, self-regulation of the relationship by the parties themselves. The main points and recommendations are as follows:

- The choice of this market form is determined largely by franchisor economic interests.
- Though the contract states that a franchisee's role is limited to that of an independent contractor, the role of a franchisee is in many ways similar to that of a consumer, as well as an investor, employee, business partner, and distributor, among others.
- A franchisee's motivations are psychological and social, and are often based on the sales claims of franchisors.
- Market interaction fails to protect the interests of stakeholders in franchising. In fact the market sets up conditions of imbalance of power and uncertainty for a franchisee that extend across the life of the relationship.

- Lack of information is a problem for a franchisee because information about the sector is dominated by franchisors whose overriding concern is to project positive images of their systems and of the sector. Other reasons why information is hard to obtain, particularly for franchisees, are the conflicts of interest between franchisors and franchisees that keep them from sharing information with each other and third parties; the threat of defamation and breach of competition law; the confidentiality of mediation and the infrequency and inconsistencies of litigation.
- Regulatory intervention is often used to address inefficiencies and inequities in market interaction. The lack of information about franchising, however, deprives regulatory process of a crucial initial element. The lack of information about franchising may make disclosure seem the perfect solution. There is evidence, which will be discussed in Chapter Six, that disclosure is not in fact the perfect solution to the problems in the franchise sector, but even if it were, it should be selected as a result of sound regulatory process.
- The next three chapters explore other layers of governance that may ameliorate the problems of imbalance of power and uncertainty in the franchise relationship. Chapters Four and Five consider the private regulation by the parties through contract. Chapter Six considers the regulation of the franchise relationship by statutory intervention, and provides an analysis of disclosure as the principal regulatory tool used in the direct regulation of the sector.

Chapter Four

Regulation by the Contract: The Standard Form and Relational Qualities of the Franchise Agreement

‘The basic picture that emerges is that franchise contracts are long-term, standard form contracts.’³⁵⁸

4.0 INTRODUCTION

Chapter Two introduced the concept of layers of governance. Chapter Three described the market layer of private regulation; it explained how market interaction can fall short of adequately protecting the interests of stakeholders in franchising. In fact it establishes imbalance of power and uncertainty in the franchise relationship. Chapter Three also introduced Williamson’s conception of contract as governance as a model for understanding how business arrangements may be regulated through the market. Here, Chapter Four discusses the contract as another layer of governance that is carried out by the parties themselves, a form of self-regulation. This chapter begins with an introduction to the nature of the franchise contract and the role it plays in the regulation of the franchise relationship; it also explains the need for uniformity in the franchise relationship and in the contract.

The remaining sections of this chapter explain the importance of the standard form and relational qualities of the franchise contract. Standard form contracts are prevalent across many species of contracting relationships. Relational contracts are also common. Both standard form and relational qualities of contract are designed to reduce transaction costs. This chapter describes the essential attributes of standard form and relational contracts and explains why the franchise contract is both a standard form and a relational contract. Two features are common to standard form contracts, unequal bargaining power and lack of negotiation. Unequal bargaining power and lack of negotiation are both justified by the need for uniformity, which is the cardinal value in business format franchising. Relational contracts can also be

³⁵⁸ Gillian Hadfield, ‘Problematic Relations: Franchising and the Law of Incomplete Contracts’ (1990) 42 *Stanford Law Review* 927, 946. Having made this observation, Hadfield focused the balance of her analysis primarily on the incompleteness of the contract rather than the standard form or the combination of the two.

defined by two features, incompleteness and longevity. Relational contracts must be flexible, sometimes to the point of being vague. They rely heavily on reciprocity and on the trust that develops over time. Chapter Four explains how the unequal bargaining power and lack of negotiation of the standard form combine with the relational contract's flexibility and trust to strongly reinforce imbalance of power in the relationship and uncertainty for a franchisee.

4.1 THE FRANCHISE CONTRACT

The franchise contract is one of several documents that may be used to define and support the franchise relationship. In franchising it is common to find that the relationship is underpinned by multiple agreements. Before considering further the attributes of the contract, it may be useful to introduce the franchise contract in its context as part of this family of documents that comprises the terms of the deal. Almost every franchise system has at least one operations manual as well as procedures and training manuals. Other documents supporting the arrangement may include the lease, a business plan, a marketing information brochure, manuals for site selection, franchise performance review, and the Franchising Code of Conduct (the Code) and Trade Practices Act (TPA) compliance materials.³⁵⁹ Ancillary to the contract or part of the contract itself may be the financing agreement, letters of credit, a non-competition agreement, guarantee and indemnity, release, supply agreement, equipment purchase or lease agreement, software licence, letters of intent, methods of payment, trademark licence, and registered user agreement. One other document is essential; although a written contract is optional, the Code requires that a disclosure document be provided in every sale of a franchise.

The range of agreements used in franchise arrangements underscores the diversity and complexity of the franchise relationships. These ancillary agreements can allow for both greater specificity and flexibility to accommodate change that may be imposed by external forces as well as change initiated by the parties. The scope of this research is, however, limited to the franchise contract.

The franchise contract may be as 'bare bones' as the regulatory environment and norms of business practice will allow, or it may be lengthy and complex. In Australia

³⁵⁹<<http://www.franchisealliance.com.au/index.php?module=Websiteandaction=Textandcontent=1098863189250-6954andparentContent=1098840720125-6130>> at 14 May 2005.

there is no requirement that the contract be in writing, but franchise contracts in Australia generally are written. While some are very brief, especially those for very small or new systems, franchise contracts for established systems often run to 60 pages or more. Franchise contracts sampled for this research ranged from about 50 to 100 pages in length, averaging about 70 pages in length.³⁶⁰ This dissertation examines the terms contained in the contracts sampled. While there is no typical franchise contract, a ‘sample’ franchise contract is contained in Giles and Terry, *Franchising Law and Practice*.³⁶¹

4.2 THE MULTIPLE ROLES OF CONTRACT

The role of contract is controversial in theory; debate continues over the significance of contract in commercial relations. Hugh Collins notes that, ‘the law of contract is a fundamental mechanism of social order’, but at the same time ‘the evidence from empirical studies of contractual behaviour indicates the marginal and sometimes socially disintegrative effects of the law of contract’.³⁶² This debate has been fuelled by research indicating that the paper document is not of primary importance to business people.³⁶³

Macaulay claims that business people fail to plan and draft carefully, to consult legal advisors, to consider their rights, and to utilize the courts with the result that the importance of contract in business relationships is overstated, ‘Contract law in action is a defective product, promising far more than it can deliver.’³⁶⁴

The role of contract in franchising has been explored to a limited degree in management and economics. Much of this research explores how contract is used to

³⁶⁰ A franchisee’s solicitor commented that this research ‘only represents the deep end of the pool’, as licence agreements caught by the Code may be only two pages.

³⁶¹ *Franchising Law and Practice*, <<http://www.lexisnexis.com.ezproxy.bond.edu.au/au/legal/results/pubTreeViewDoc.do?nodeId=TAAKAAF&pubTreeWidth=23%25> at 2 March 2007.

³⁶² Collins, *Regulating Contracts* (1999).

³⁶³ See, *inter alia*, Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ in David Campbell, Hugh Collins, and John Wightman, (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) and Ian R. Macneil, ‘Contracts: Adjustment of Long-Term Economic Relations under the Classical, Neo-classical, and Relational Contract Law’ (1978) 72 (6) *Northwestern University Law Review* 854.

³⁶⁴ Macaulay in Joerges, Christian (ed) *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 189.

govern the relationship, as, for example, it establishes an organizational structure that reduces transaction costs.³⁶⁵ The role of the franchise contract has also been considered in legal research of relational contracts, and as part of analysis of the franchise contract as a standard form contract.³⁶⁶ Some general treatment of the franchise relationship has included commentary on the contract throughout its analysis.³⁶⁷ These articles provide a foundation for further analysis in this dissertation of the role of contract in the regulation of the franchise relationship.

Some argue that contract is indeed of small significance in franchising. Contract is only one of many documents that support the relationship. Many franchisors say that it is true that the contract only comes out of the drawer in the case of a dispute, a view that supports the idea that more intimately bound firms behave in a less strictly contractual way.³⁶⁸ Franchise systems, because of the closeness of the association between franchisor and franchisee, might be expected to put less emphasis on contract.³⁶⁹ The long-term relationship means parties are likely to rely on other means to regulate. There is a widespread view that the contract ‘only comes out of

³⁶⁵ See generally, Deepak Agrawal and Rajiv Lal, ‘Contractual Arrangements in Franchising: An Empirical Investigation’ (1995) 32(2) *Journal of Marketing Research* 213; James A. Brickley, ‘Incentive Conflicts and Contractual Restraints: Evidence from Franchising’ (1999) 42 *Journal of Law and Economics* 745; Francine Lafontaine and Kathryn L Shaw, ‘The Dynamics of Franchise Contracting: Evidence from Panel Data’ (1999) 107 *Journal of Political Economy* 1041; Francine Lafontaine and Margaret E. Slade, ‘Incentive Contracting and the Franchise Decision’ in Kalyan Chatterjee and William F. Samuelson (eds), *Game Theory and Business Applications* (2001); G. Frank Mathewson and Ralph A. Winter, ‘Territorial Restrictions in Franchise Contracts’ (1994) 32(2) *Economic Inquiry* 181; Andrew C. Selden *Principles of Effective Franchise Contracts* (2000) Briggs and Morgan <<http://www.briggs.com/CM/Articles/article83.asp>> at 1 November 2004; Janet Bercovitz, *An Analysis of the Contract Provisions in Business Format Franchise Agreements* (1999) International Society for New Institutional Economics <<http://www.isnie.org/ISNIE00/Papers/Bercovitz.pdf>> at 8 December 2004; and S. Watson and G. Gunasekara, ‘Regulating Business Format Franchising: Familiar Solutions for Novel Problems’ (2006) 12 *NZBLQ* 174.

³⁶⁶ See, for example, Antony W. Dnes, ‘A Case-Study Analysis of Franchise Contracts’ (1993) 22 *Journal of Legal Studies* 367; Gillian Hadfield, ‘Problematic Relations: Franchising and the Law of Incomplete Contracts’ (1990) 42 *Stanford Law Review* 927; James Jordan and Judith Gitterman, ‘Franchise Agreements: Contracts of Adhesion?’ (1996) 16 *Franchise Law Journal* 1; Goddard, David, ‘Long-Term Contracts: A Law and Economics Perspective’ [1997] *New Zealand Law Review* 423; Andrew Terry, ‘Franchising, Relational Contracts and the Vibe’ (2005) 33(4) *Australian Business Law Review* 289; and Günter Teubner, ‘Beyond Contract and Organisation? The External Liability of Franchising Systems in German Law’ in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 105.

³⁶⁷ Steinberg and Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn State Law Review* 105.

³⁶⁸ George Dent, ‘Lawyers and Trust in Business Alliances’ (2002) 58 *Business Lawyer* 45, n 120.

³⁶⁹ They are, for example, treated in competition law as being more closely bound, and therefore granted certain exemptions from its requirements. See Alan Meese, Antitrust Balancing in a (Near) Coasian World: The Case of Franchise Tying Contracts, 95 *Michigan Law Review* 111 (1996).

the drawer in case of a dispute.’ There is also the view, put forward by the Executive Director of the Franchise Council of Australia, that the franchise contract is largely a reflection of regulatory requirements.³⁷⁰

Yet, despite such evidence, franchisors continue to go to the considerable expense of drafting contracts, franchisees continue to sign them; legislators continue to address them; and courts continue to interpret them. Commentators continue to explore the roles that the contract plays in a commercial relationship.³⁷¹ Much of the current legal research proceeds from an acceptance that contract is not only about the paper deal, but it is also the ‘real deal’ and the relationship.³⁷² As Hugh Collins’ analysis in *Regulating Contracts* amply demonstrates, though it may be controversial, contract retains its potential to play important roles both as an instrument and as an object of regulation.³⁷³

This research affirms that contract is a versatile tool. In the franchise relationship it plays several roles. Not only is contract an instrument of self-regulation, but it is also an object of regulation. Franchising is a concrete example of Collins’ observation that, ‘[t]he topic of *Regulating Contracts* requires us to view contracts both as the subject of regulation, and, at the same time, as a type of regulation governing contractual practices.’³⁷⁴ In this research contract plays yet another role as a tool to gauge the effectiveness of the regulation of the franchising sector.

4.2.1 Contract as an instrument of self-regulation

As an instrument of regulation, contract is an early point of contact and the subject of negotiation between the parties about the nature of their ongoing relationship. Negotiation of the contract can set the tone of the relationship, even if the parties are fortunate enough never to have to refer to it again. Negotiation of the contract is

³⁷⁰ Telephone interview with Richard Evans, FCA Executive Director (2004.)

³⁷¹ R.A. Hillman, ‘The Crisis in Modern Contract Theory’, 67 *Texas Law Review* 103 (1988).

³⁷² See, for example, Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ in Campbell, David, Collins, Hugh and Wightman, John (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 51; Macneil, Ian R., ‘A Primer of Contract Planning’ (1975) 48 *Southern California Law Review* 627; and Lisa Bernstein, ‘Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry’ (1992) 21 *Journal of Legal Studies* 115.

³⁷³ Hugh Collins, *Regulating Contracts* (1999).

³⁷⁴ Hugh Collins, ‘Regulating Contracts’ in C. Parker, C. Scott, N. Lacey and J. Braithwaite, (eds), *Regulating Law* (2003) xxvi.

therefore critical to the relationship between franchisor and franchisee. What is most interesting about this aspect of the role of contract in franchising is that, due to the standard form nature of the contract; with this sort of contract there is very little negotiation. A franchisor does not permit negotiation of most contract terms, which are instead presented to a franchisee on a take-it-or-leave-it basis.

The contract also informs the structure of franchising as organizational form; it is a form of governance of the franchise organization, as an alternative to planning, promise and competition.³⁷⁵ The contract as governance outlines a matrix of overlapping roles of franchisor and franchisee, serving both as a means for parties to organize themselves and as a guide to public entities (courts and regulators) on how to interpret the relationship. The contract puts in place the regulatory mechanisms for a franchisor to monitor a franchisee, to provide performance incentives, to allocate risk, manage externalities, information asymmetry, and facilitate information search, entrepreneurship and interdependence. Much of the nature of the relationship as described in Chapter Three is reinforced and codified through the contract.

The contract as a commodity is a piece of the package for which the franchisee is paying. As such, the contract has potential to play a role as a sales tool; it can signal to the buyer that the seller's entire package is an attractive one. Jim Penman writes that it should be 'an offer too good to refuse'.³⁷⁶ It appears, however that it is unusual for a franchisor to view the contract in this way. 'An informed consumer is our best customer' is not the approach usually taken in the marketing of franchising. There is, as will be discussed in Chapter Seven, little current application of a 'market for terms', though this mechanism could be developed through better information, participation and collaboration.

The contract prescribes methods of conflict management and resolution, and so has the potential to promote the long-term strength of the relationship. Even if the contract only comes out of the drawer in case of a dispute, that role alone is an important one. Disputes are critical to the relationship, and they can be handled in a variety of ways; the contract is central to processes of negotiation, mediation, and litigation, and it helps the parties to predict outcomes of dispute settlement processes.

³⁷⁵ See Oliver Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' (1979) 22(2) *Journal of Law and Economics* 233.

³⁷⁶ Jim Penman, *What Will They Franchise Next?: The Story of Jim's Group* (2003).

The contract also outlines the parties' rights and obligations at the end of the relationship by way of transfer or termination.

The contract also impacts on third parties such as suppliers and investors. Lawyers, lenders, prospective business partners, anyone with an interest in the relationship who is not a party to it, will also look to the contract for clarification of what is expected. Gillian Hadfield writes, '[T]he heart of franchising's legal structure is still contract.'³⁷⁷ As Richard Evans of the FCA puts it, 'It is a contract relationship, and needs to be understood as such.'³⁷⁸

A 'contractual relationship' can, however, mean many things. Blair and Lafontaine suggest that that a franchisee should,

'recognize his contract for what it is. It is not an opportunity to develop a business and invest in developing a brand in partnership with a franchisor, but rather a short-term licence from which the franchisee must derive short-term benefits...it makes sense to think of a franchise contract as a rental contract over an intangible asset, namely the brand, with the terms of the franchise contract clearly defining the relationship.'³⁷⁹

Blair and Lafontaine stress that the arrangement is a contract of fixed duration. A franchisee is contracting for the right to use a particular trademark in a particular location for a particular time period; it is not establishing its own fully-transferable, independent business.

Blair and Lafontaine believe that this approach to understanding the relationship is not cultivated by franchisors; they speculate that this is because franchisors believe it would change the attitude of franchisees toward the enterprise. Franchisees would no longer consider themselves as owners of their own businesses, as franchisors want franchisees to do to ensure franchisee effort and commitment and to reduce agency costs. Different contractual and other devices to manage a franchisee would then be required,

'Any franchisor that wants more than a local finite-term focus from its franchisees must embed extra franchise rights and expectations within the contract: verbal promises to the franchisee about future prospects should never

³⁷⁷ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 939.

³⁷⁸ Richard Evans, CEO of the Franchising Council of Australia, quoted in 'Follow the Winning Plan', *The Australian* (Sydney), 30 June 2006, 12.

³⁷⁹ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 221.

suffice from the franchisee's perspective (they are not worth the paper they are written on!), especially in light of the frequent use of integration clauses...' ³⁸⁰

The words from the quote above, '*with the terms of the franchise contract clearly defining the relationship*' are significant because many contract terms provide for high levels of franchisor flexibility and discretion, but are poorly understood by a franchisee. For example, the Scope of Grant term of the contract usually specifies that the contract entered into by a franchisee for the intellectual property is not an exclusive one, and misunderstanding about what this means can lead to problems throughout the course of the relationship. The Scope of Grant and other contract terms are discussed in greater detail in Chapter Five. For the purposes of this Chapter, the point is in Blair and Lafontaine's message: an accurate understanding of the nature of the contractual agreement is critical to understanding the relationship.

4.2.2 Contract as an object of regulation

The distinction between contract and corporation influences the regulatory approach. The contract as the object of regulation assumes equality of partners, non-disclosure of preferences, *ex ante* definition of performances and immutable contractual duties; the corporation as object of regulation assumes corporate governance where there is latent inequality of partners, adaptation of performance and duties through majority vote, exit possibilities, and delegation of management to specialists who act as fiduciaries to capital owners.³⁸¹ Though franchising is often spoken of as an industry or an industry sector, it is fundamentally a contractual relationship and the regulation of franchising is the regulation of a contractual relationship. The sector-specific regulation of franchising in Australia, the Franchising Code of Conduct protects the contractual relationship, and the assumptions that support legal conceptions of that relationship. It may be appropriate to consider franchising as an organizational form, but that was not the approach taken in the drafting of the Code.³⁸²

³⁸⁰ *Id.*, 292.

³⁸¹ Erich Schanze, 'Beyond Contract and Corporation: The Law and Economics of Symbiotic Arrangements' in Riis, Thomas and Nielsen, Ruth (eds), *Law and Economics: Methodology and Application* (1998) 113, 117. Schanze observes that such a distinction is consistent with differences in regulation in civil and common law. The common law of contract tends to ignore duration and relational intensity. This deficiency of the common law of contract serves as a point of departure for McNeil and Macaulay's criticisms of contract law.

³⁸² There is other commercial regulation in Australia that impacts upon franchising as an organizational form, such as the competition law provisions of the Trade Practices Act (the TPA), but this legislation,

As an object of regulation, contract is the means by which regulators impose requirements on the parties in the relationship. In the case of franchising, regulation imposes procedural requirements on a franchisor, such as allowing a cooling-off period, procedures to help ensure fairness in transfer and termination procedures, and disclosure. All of these requirements pertain to formation or performance of the contract. The contract also acts as a blueprint for and signals conformance with government regulation.

What is most significant about the role of contract in the regulation of the franchise relationship in Australia is that disclosure, the one of the main tools used to regulate, is focussed on the contract. Of the approximately seventeen contract terms that are subject to Code requirements, most (twelve) of the requirements call for disclosure as the only form of regulatory intervention. Table 4.1 outlines how the clauses typically found in a franchise contract are subject to regulation through direct intervention. It represents the applicable regulation, if any, for each term found in a typical franchise contract. Its focus is on franchise-specific regulation of the relationship but does not note where other regulation applies. While the Table is not an exhaustive list of all the terms that may be found in franchise contracts, it covers most of the commonly used terms.

is beyond the scope of this dissertation with its focus on the regulation of the franchise relationship through the Code.

**Table 4.1: Contract as an Object of Regulation/
Applicable Regulation by Contract Term**

CONTRACTUAL PROVISIONS COMMONLY FOUND IN FRANCHISE CONTRACTS	APPLICABLE REGULATION
Clauses regulated by disclosure requirements (to be provided to franchisee at contract formation)	
Grant of Franchise (Scope of Grant)	Disclosure 8
Term and Renewal of Franchise	Disclosure 17
Franchisor's Obligations	Disclosure 15
Franchisee's Obligations	Disclosure 16
Fees/Payments	Disclosure 13
Term (Duration)	Disclosure 17
Right of Renewal	Disclosure 17
Restrictive Covenants	Disclosure 18
Restraint of Trade	Disclosure 18
Adjustments	Disclosure 17
Intellectual Property/Rights in the System	(see Disclosure 18 – ongoing Disclosure requirements re change in IP)
Obligations on expiration or termination	Disclosure 17
Clauses with substantive regulation (Disclosure requirements may also apply)	
Products and Supplies	Disclosure 9,10; TPA 45,47,48, 96
Minimum Performance and Reporting Requirements	Disclosure 16, 9,10; TPA 45,47,48
Area Development Plans	Disclosure, also section 51AC
Franchisor Advertising and Marketing	FCC Clause 17 Reporting by franchisor, Disclosure 12
Termination	FCC Clause 20-23
Transfer	FCC 20,21, Disclosure 17
Guarantee and indemnity	FCC Clause 16, no general release of franchisor toward franchisee
Meetings/Franchise Advisory Council	FCC Clause 15 Franchisees' freedom to associate
Dispute Resolution	FCC Part 4
Cooling-off	FCC Clause 13

As Table 4.1 indicates, many of the key terms in franchise contracts are regulated through disclosure. Clauses not regulated through specific disclosure requirements or substantive Code provisions include operations manual; independent contractor; severability and construction; approvals and waivers; entire agreement; *force majeure*; applicable law; GST; acknowledgment; death, disability, mental incapacity; maintenance of the store/inspection; training; notices; accounts; insurance; and covenants.

Contract is thus an important layer of self-regulation, it is also an instrument of public regulation by courts in interpreting the relationship, and a focal point of direct intervention, especially disclosure. This dissertation argues that the contract plays such important roles that should be employed with care, with an awareness of the qualities of the contract itself, and of its prejudices and its limitations. Later sections of this chapter outline how the standard form and relational qualities of the contract give rise to certain limitations on the use of contract to regulate the franchise relationship. Before getting to those points, however, it is necessary to consider the importance of uniformity, an aspect of the franchise relationship that is critical both to the relationship and to an understanding of the franchise contract.

4.3 UNIFORMITY: THE CARDINAL VALUE IN FRANCHISING

One of the contracts in the sample contains the following clause,

‘The Franchisee acknowledges that it is imperative the standards of quality and uniformity of the Franchisor System be maintained. Accordingly, the Franchisee agrees that the Franchisor has the right to set such standards of quality and to make such policies and rules from time to time, as the Franchisor may determine. The Franchisee agrees to abide by and be bound by all such standards, policies and rules and any non-compliance shall constitute a breach of this agreement...’³⁸³

Uniformity is of critical importance in business format franchising; it helps a franchisor to achieve important objectives including brand maintenance, the reduction of strategic risk and risk related to externalities and moral hazard, and the containment of transaction costs. It also helps protect a franchisor against franchisee claims of unconscionable conduct. These are dealt with in turn in the following sections.

³⁸³ System F9.

4.3.1 Uniformity is crucial to brand maintenance

Traditionally in franchising, uniformity (in products, levels of service, cleanliness and other standards) has been considered the key to a successful operation. The economists Blair and Lafontaine write that,

‘The strength of franchise systems does not lie in the *absolute* quality of the products offered. Instead, it resides largely in the capacity of the franchised chain to offer a *uniform* product at reasonable prices.’³⁸⁴

The following query posted on the American Bar Association (ABA) Forum on Franchising listserv illustrates the importance of uniformity to a franchisor. Michael Seid’s reply to the listserv enquiry provides an insight into the zeal with which franchisor consultants defend uniformity:

Enquiry to listserv: ‘Can anyone cite me to the case (if it wasn’t just someone’s hypothetical) where a franchisor attempted to enforce system standards against a franchisee who was exceeding system standards by serving fresh squeezed real orange juice instead of reconstituted stuff out of a container, which led to complaints by other franchisees?’

Seid’s Reply: ‘They had not exceeded system standards. For example, a McDonald’s franchisee deciding to have less fat in their burgers would change the taste and texture. Changing the brining on Coca Cola could make it sweeter or less sweet. Putting bigger desks in a Marriott Courtyard might make the working area bigger but the living area smaller. Adding moisture content in cheese used for pizza might cause the bread to burn or the pepperoni to cup because the melt time and temperature needs to change. They had not exceeded system standards - they had *violated* the system standards.’³⁸⁵

As the court recognized in a noted Canadian case:

‘...it is vital to the integrity and success of the entire franchise system that the standards be uniform and that they be enforced. Uniformity must be central to the identity of the system. And maintenance of identity and uniformity must be central to continued operation of the system for all.’³⁸⁶

Uniformity is critical to effective brand maintenance. Imbalance of bargaining power in the franchise relationship stems in large part from the strict control over the system that a franchisor exercises in the name of the need for uniformity in franchise

³⁸⁴ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 117.

³⁸⁵ Enquiry posted on the ABA Forum on Franchising Listserv 1 February 2005 and replied to by Michael H. Seid 2 February 2005.

³⁸⁶ *Coordinated Corporate Services Ltd v National Video Inc* (1984) 2 CPR (2d) 251, 755. The case also acknowledges the difficulties that can be encountered by franchisors in dealing with franchisees who may be in breach and who, by continuing to operate, may be damaging the goodwill of the franchise.

contracts. It is the essence of franchising that the brand be clearly identifiable and that franchisees conform to a franchisor's branding formula. In order to ensure uniformity franchisors try to maintain absolute authority over the terms of the relationship. One further quotation reinforces this point,

'Franchising is ultimately an extremely competitive industry.... To succeed, a franchisor must constantly watch its backside for approaching competitors, as well as learn how best to gain on the competitor in front of it. To win, or even be in, the race, the franchisor must have an absolute right to respond to market changes and set the direction of its system--right or wrong. It must be free to take all varieties of risks without a concern that the wisdom of its decision might be second-guessed in a courtroom.'³⁸⁷

4.3.2 Uniformity reduces risk

Risks for a franchisor include operating risk as well as strategic and reputational risks related to a franchisee. Operating risk is defined as 'the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.'³⁸⁸ The choice to franchise decreases a franchisor's operating risk over that of a company-owned store, as a franchisee assumes the operating risk for the unit. The addition of a franchisee, however, can increase a franchisor's strategic and reputational risks to the extent that a franchisee is able to exercise discretion in both the operation of the unit and the use of resources.³⁸⁹ To contain these franchisee-related risks a franchisor imposes tight controls on the exercise of discretion by a franchisee. Thus, a franchisor relies on uniformity to help contain risk.

Uniformity in the system also reduces the negative impacts of externalities within the system. Economists view voluntary exchange as mutually beneficial to both parties, but consumption and production often have external effects that can lead to moral hazard. Franchisors are concerned with a form of moral hazard known as 'free-riding' where a franchisee shirks on the trade name or brand. In the case of a particular franchise unit, when repeat customers accrue to the benefit of that particular

³⁸⁷ William L. Killion, 'Putting Critical Decision-Making Where It Belongs: Scouring the Franchise Agreement for the "D" Word' (2005) 24 *Franchise Law Journal* 228, 230.

³⁸⁸ According to §644 of *International Convergence of Capital Measurement and Capital Standards*, known as Basel II, "operational risk" is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

³⁸⁹ Phillip H. Phan, John E. Butler, and Soo H. Lee, 'Crossing Mother: Entrepreneur-Franchisees' Attempts to Reduce Franchisor Influence' (1996) 11 *Journal of Business Venturing* 370. The Basel II definition in the previous note includes legal risk, but excludes strategic risk: that is the risk of a loss arising from a poor strategic business decision. This definition also excludes reputational risk.

franchisee, the externality is low and there are positive incentives for that franchisee to cultivate his customers.³⁹⁰ A McDonald's unit located in a local shopping center may see a high percentage of repeat customers, and so that franchisee will be interested in offering high quality service to those customers, as it will directly benefit from the repeat business. But where a franchise unit has a high number of non-repeat customers or its repeat customers accrue to the benefit of other franchisees in the system, such as in the case of a McDonald's unit located at a busy metropolitan highway interchange, high externalities may tempt a franchisee to free-ride and under-invest in its operation.³⁹¹

A franchisor employs a variety of means to protect the brand against the risks of franchisee free-riding. Franchisee temptation to free-ride can be reduced through the use of incentives or a franchisor can step up its monitoring. Alternatively, in the case of demand externality, for example, where the low price at one outlet increases demand at all outlets, a franchisor may impose uniform pricing, further eroding a franchisee's local control.³⁹² Franchisors may also respond to externalities through choice of organizational form. High externalities can signal a need for greater vertical integration, as franchisee free-riding leads a franchisor to prefer to run the unit as a company-owned store and hire a manager, whose compensation may not be tied as directly to the performance of that particular unit.³⁹³

³⁹⁰ James A. Brickley, 'Incentive Conflicts and Contractual Restraints: Evidence from Franchising' (1999) 42 *Journal of Law and Economics* 745, 749.

³⁹¹ Examples of high externality industries are: auto/truck rental, donuts/cookies/bakeries, ice cream, and take-out restaurants (eg pizza). Externalities are also higher when franchised units are located closer together. Examples of intermediate externality industries are home furnishings and athletic wear. Low externality industries include: auto products, health and fitness, dry cleaning, lawn care, travel agents, hair styling and other industries that involve relatively high customer-specific investment that reinforces repeat customers, in James A. Brickley, 'Incentive Conflicts and Contractual Restraints: Evidence from Franchising' (1999) 42 *Journal of Law and Economics* 745, 755-756

³⁹² Competition law in many jurisdictions, including Australia, makes certain exceptions that allow limited forms of product tying and price maintenance practices in the franchising context.

³⁹³ Lafontaine's research on variation in the franchise contract found that most variables did not affect contract terms, but rather manifested themselves in a franchisor choice to vertically integrate, i.e. to operate a company-owned unit, rather than to segregate, i.e. to sell a franchise unit. With respect to the above example, a franchisor's role in maintaining brand/TM is particularly important where business is transient, e.g. at highway locations. The results also show that where brand/TM is more valuable, there is more vertical integration. Finally, Lafontaine expected to find that smaller outlets have greater tendency to franchise since they can internalize less of the externality. She instead found that larger outlet size correlated with greater company ownership (and low power incentives to company agents) See Francine Lafontaine and Margaret E. Slade, 'Incentive Contracting and the Franchise Decision' in Kalyan Chatterjee and William F. Samuelson (eds), *Game Theory and Business Applications* (2001) 146-157.

While uniformity reduces variation among stores and so helps to control externalities, it can also create market inefficiencies that lead to other types of moral hazard, for example, where responsibility for risk is assigned to one party, but the other party still has control over relevant risk factors.³⁹⁴ This situation arises where a franchisee makes contributions to advertising funds which a franchisor can spend at its discretion and where a franchisor has discretion to require franchisee to purchase from a supplier whose products are more expensive, but who will pay a franchisor a commission. A franchisor benefits but will not suffer the costs, as a franchisor's royalty is calculated on franchisee gross turnover, not franchisee net profit.

A franchisor is also vulnerable to opportunistic behaviour on the part of a franchisee, such as free-riding, as well as cheating, inaccurate reporting, and withholding of information; or appropriation of intellectual property. Unlike a franchisee, however, a franchisor is able to limit opportunistic behaviour of a franchisee through contractual terms such as accounting and reporting requirements, minimum performance requirements, vertical restraints, and shifting of risk to a franchisee. This option of using the contract to contain the other party's opportunistic behaviour is unavailable to a franchisee because a franchisee neither drafts nor is able to negotiate contract terms. Moral hazard is thus a problem that only a franchisor can control through contract, crafting uniform contract terms to protect against risks, often by shifting them to franchisees.

4.3.3 Uniformity contains transaction costs

The franchise form exists largely to save transaction costs. Uniformity in drafting of contracts contains the transaction costs of entry into the relationship. A franchisor's costs would soar if each franchisee were governed by a different contract with its own individually-negotiated terms and provisions. Repetition of the same documents, processes and procedures with every franchisee in the system creates economies of scale in the preparation of the contract documents, administration and regulatory compliance. If a franchisor negotiates a different term, not only will a franchisor have to draft and monitor different franchise contracts, but also it will have to prepare

³⁹⁴ The classic example of this type of moral hazard is insurance contracts.

different disclosure documents for each franchisee. Disclosure is considered onerous by franchisors even without this added burden.³⁹⁵

After the contract is signed, uniformity leads to ease of administration that also keeps transaction costs down, 'If there is not a high degree of uniformity, there can be difficulties for a franchisor in administering the system.'³⁹⁶ Lower agent service levels, particularly lack of compliance with the system and failure to pay fees, correlate with higher monitoring costs, as a franchisor must spend more to ensure compliance.³⁹⁷ Generally, a franchisor seeks to contain these costs through unilateral governance and strict, uniform standards that are imposed through the contract as well as other documents supporting the relationship. Uniformity is therefore a key tool for a franchisor to maintain the system standards, to keep costs down, and to control externalities.

4.3.4 Uniformity protects a franchisor against claims of unconscionability

Finally, uniformity in the form of a franchisor's consistent treatment of franchisees can be an indication of fairness.³⁹⁸ If a franchisor negotiates the terms of the deal with each franchisee, the contracts will vary, leaving a franchisor open to claims of favouritism and unfair treatment of some franchisees. The *Trade Practices Act 1974* (the TPA) section 51AC codifies this concern.³⁹⁹ Uniformity of the contract is addressed with respect to unconscionable conduct in TPA section 51AC(3). TPA section 51AC(3)(f) considers 'whether the stronger party's conduct was consistent with its conduct in similar transactions'. This provides another reason for franchisors to insist on consistency in contract terms, as regulation effectively mandates it. Thus,

³⁹⁵ In the U.S material modification has to go into the Uniform Franchise Offering Circular (UFOC), effectively mandating that such changes to the contract must apply to all franchisees. See James V. Jordan and Judith B. Gitterman, 'Franchise Agreements: Contract of Adhesion?' (1996) 16 *Franchise Law Journal* 1, 42: 'franchise agreements are often drafted as form contracts because of the constraints imposed on franchisors by state legislatures. For example, under the California Negotiated Sales Rule, the initial offer to a franchisee must be the offer that has been registered with the Department of Corporations. If the franchisor negotiates a change with a franchisee, the UFOC must be amended to disclose the negotiated terms. Additionally, the franchisor must attach all notices of negotiated sales within the past twelve months to the offering circular.'

³⁹⁶ Andrew C. Selden, 'The Negotiated Franchise: A Trap for the Unwary' (1983) 7 *International Franchise Legal Digest* 2.

³⁹⁷ Deepak Agrawal and Rajiv Lal, 'Contractual Arrangements in Franchising: An Empirical Investigation' (1995) 32(2) *Journal of Marketing Research* 213.

³⁹⁸ See *Trade Practices Act 1974* (Cth) section 51AC.

³⁹⁹ *Ibid.*

TPA section 51AC reinforces a franchisor's power and its refusal to negotiate contract terms. Imbalance of power has been a cornerstone of the unconscionability doctrine; yet in this case imbalance of power may be reinforced by the statutory elements of unconscionability.⁴⁰⁰

Uniformity is critical to the relationship, the system, and the brand. It underpins the standard form and the discretion of franchisors and so the power imbalance and uncertainty for franchisees. As the next sections will outline, the standard form also combines with the relational qualities of the contract to further increase imbalance of power and uncertainty for a franchisee.

4.4 THE FRANCHISE CONTRACT: STANDARD FORM AND RELATIONAL

4.4.1 The franchise contract as a standard form contract

A standard form contract has been defined as,

‘a contract that is not individually negotiated by the parties but is instead drafted by one party who uses a contract containing the same terms for all transactions of that type. The drafting party may be in the superior bargaining position and may offer the contract on a take-it-or-leave-it basis. Standard form contracts are sometimes called ‘contracts of adhesion’ because the party in the inferior bargaining position who wishes to contract must adhere to what is demanded by the party in the superior position, there being no room to negotiate.’⁴⁰¹

The essential defining elements of such contracts are the lack of negotiation of terms and unequal bargaining power. The following section explains these two essential elements of the standard form as they are manifest in franchise contracts.

⁴⁰⁰ The problem is that section 51AC equates consistency with fairness. Consistency and fairness are two distinct and not necessarily compatible concepts. To the extent that ‘fair’ implies honesty and/or justice, a sharp practice does not become fairer because it is applied consistently. For a discussion on the connection between unconscionability and balance of power see Daniel D. Barnhizer, ‘Inequality of Bargaining Power’ (2005) 76 *University of Colorado Law Review* 139.

⁴⁰¹ Peter E. Nygh and Peter Butt (eds), *Butterworth's Australian Legal Dictionary* (1997). Note that the distinction between standard form and adhesion contracts is not clear; many writers and legal resources use the terms interchangeably. This article will use the term ‘standard form’ because of the negative connotations of the term ‘contract of adhesion’. See Freidrich Kessler, ‘Contracts of Adhesion - Some Thoughts about Freedom of Contract’ (1943) 43 *Columbia Law Review* 629.

4.4.1.1 Lack of negotiation of terms

Interviews with franchisors, franchisees and their counsel suggest that it is widely accepted within the sector that franchise contracts are not negotiated.⁴⁰² One or two minor adjustments may be countenanced, but in general the contract is part of the product that a franchisee can choose to purchase/invest in or not, but cannot expect to have custom-tailored to his particular requirements. A franchisee's lack of franchisee bargaining power is closely related to the fact that there is no negotiation of contract terms. As Gillian Hadfield observed,

'The reputable company will not change its contract; it will rarely let it be examined until the prospective purchaser has made a deposit towards the purchase. It will not compromise or negotiate any part of it. The attorney representing a prospective purchaser need only determine with him if the client can live within the framework of the franchise agreement. If it is oppressive or confiscatory, the client is best advised not to sign. If the franchise company offers to negotiate away any of its requirements to make the sale, it can only be an indication of the weakness of the company.... [There is] a clear ethic of non-negotiation, not merely to boost the bargaining power of the franchisor, but also to define what, fundamentally, it is that the franchisee is purchasing. In other words, franchisors use the standard form contract to signal aspects of the relationship that the franchisee can expect -- the relational elements of company structure and philosophy. Buyers' guide authors echo this same norm. The clear message is that the refusal of the franchisor to negotiate -- the superior position of the franchisor -- is a hallmark of the relationship that the franchisee is purchasing.'⁴⁰³

Hadfield's observations highlight several reasons why franchisors do not negotiate. Uniformity and the need for strict franchisor control is the most common justification, but franchisor unwillingness to negotiate also signals to a franchisee the nature of the relationship and the superior position of a franchisor. Thus, there is a direct relationship between a franchisor's failure to negotiate and power in the relationship. Just as inequality of bargaining power contributes to the lack of negotiation, lack of negotiation reinforces inequality of bargaining power. If there is no negotiation possible for the non-drafting party, the bargaining positions of the parties are by definition, unequal.

⁴⁰² Franchisors' solicitors meet at trade conferences and recount with a combination of amusement and horror their stories of franchisee solicitors submitting to them lists of changes to the agreement.

⁴⁰³ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 961

4.4.1.2 Lack of bargaining power

Bargaining power is defined as, ‘The ability to get a large share of the possible joint benefits to be derived from any agreement.’⁴⁰⁴ Daniel Barnhizer discusses the concept of bargaining power in a 2005 University of Colorado Law Review article,

‘As a distinct legal concept, the doctrine of inequality of bargaining power is a relatively recent invention. Its provenance lies in the late 19th Century social and economic reactions to the perceived abuses of laissez-faire economic regulation... In the 1940s and 1950s, bargaining power became entrenched in contract law, particularly after adoption of Uniform Commercial Code ("U.C.C.") 2-302 which expressly authorized courts to assess the parties' bargaining power under the rubric of unconscionability.’⁴⁰⁵

The standard form contract is typically entered into between unequal bargaining partners, ‘The consumer is not in a position to negotiate the terms and the company's representative often does not have the authority to do so.’⁴⁰⁶ The weaker party to the contract therefore has little voice in setting its terms.⁴⁰⁷ Barnhizer's analysis of judicial approaches to bargaining power finds that,

‘The judicial inquiry can be divided into two rough categories. First, many courts address inequality of bargaining power in terms of the weaker party's lack of meaningful alternatives, necessity, the nature of the good or service, or inability to negotiate terms. Second, courts often employ a host of potential factors relating to characteristics of the parties and characteristics of the transaction to imbue the inequality of bargaining power doctrine with standards to guide the exercise of judicial discretion. Typical characteristics of individual parties relied upon by courts to support an inference of inequality of bargaining power include wealth, business sophistication, education or knowledge, race, gender, "size" of the parties, monopoly power, and consumer status. And as a final alternative, many courts eschew standards for assessing inequality of bargaining power, relying instead upon a "we-know-it-when-we-see-it" approach. The inconsistency with which different courts approach these separate analyses and the fact that few courts or commentators have analyzed the relative importance of these factors to the question of bargaining power disparities mean that there is no predictable judicial standard for determining inequality of bargaining power. As a result, "inequality of bargaining power" can be fairly

⁴⁰⁴ John Black, *A Dictionary of Economics*, Oxford University Press, 2002. *Oxford Reference Online*. Oxford University Press. Bond University. 20 November 2006 <<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e185>>

⁴⁰⁵ Daniel D. Barnhizer, ‘Inequality of Bargaining Power’ (2005) 76 *University of Colorado Law Review* 139, 194-195.

⁴⁰⁶ Peter E. Nygh and Peter Butt (eds), *Butterworth's Concise Legal Dictionary* (3rd ed. 2004) ‘standard form contract’, 406.

⁴⁰⁷ *Cubic Corp. v Marty* 229 2d 828 (Cal. App., 1986); *Standard Oil Co. of California v Perkins*, 396 F 2d 809 (1969).

described as a doctrine in search of content and substance. After almost a century of searching, the doctrine remains obscure.⁴⁰⁸

While traditionally courts have treated commercial agreements with a presumption of equal bargaining power, in the franchise context this is not a legitimate assumption,

‘Although franchise agreements are commercial contracts they exhibit many of the same attributes of consumer contracts. The relationship between franchisor and franchisee is characterized by a prevailing ... inequality of economic resources between the contracting parties The agreements themselves tend to reflect this gross bargaining disparity. Usually they are form contracts the franchisor prepared and offered to the franchisee on a take-it-or-leave-it basis.’⁴⁰⁹

The main factor in the bargaining position equation is the need for franchisor control in the interests of brand maintenance, system administration and the containment of transaction costs and negative externalities. Uniformity is the main reason why franchisors do not negotiate contracts with franchisees; uniformity is also the justification for concentration of power in the hands of a franchisor. Franchisor Jim Penman has documented his experiments with democratic processes in his systems and concludes that while democracy sounds good, ‘benign dictatorship works better.’⁴¹⁰

The imbalance of power in the franchise relationship can also be due to inequality of economic resources. In addition, many of the factors cited by Barnhizer, such as wealth, business sophistication, education or knowledge, "size" of the parties, monopoly power, and consumer status also contribute to the disparity in the franchise relationship.

Added to the need for uniformity and to the factors outlined in Barnhizer’s article, there are several other reasons why bargaining power is not equal in the franchise relationship, such as franchisee inexperience, franchisee psychology, and disparities in legal representation. These factors can also help explain the lack of negotiation of the franchise contract.

As described in Chapter Three, franchisee inexperience contributes to a franchisee’s relative lack of power throughout the relationship. First, prospective franchisees are

⁴⁰⁸ Daniel D. Barnhizer, ‘Inequality of Bargaining Power’ (2005) 76 *University of Colorado Law Review* 139, 199-201.

⁴⁰⁹ James V. Jordan and Judith B. Gitterman, ‘Franchise Agreements: Contract of Adhesion?’ (1996) 16 *Franchise Law Journal* 1, 16.

⁴¹⁰ Telephone interview with Jim Penman, CEO of Jim’s Franchise Systems (2003).

often new to business ownership. A recent survey showed that only one in five franchisees in Australia make over \$100,000 per year.⁴¹¹ A successful, experienced businessperson is not the prototypical purchaser of a franchisor's product, which is all about the 'tried and tested system' and being 'in business for yourself, but not by yourself'. Franchisee individualism, optimism and naiveté add to the imbalance of power. A franchisee is relying largely on perceptions created by the assiduous marketing efforts of franchisors and on the 'trust us' aspect of the relationship that franchisors require for the sake of control and uniformity.

In addition, the timing of the presentation of the contract also affects a franchisee's bargaining position. Franchise contracts are confidential, often only provided to prospective franchisees at a relatively late stage in the negotiation process.⁴¹² A franchisee is asked to sign the contract at a time when entrepreneurial individualism and optimism are near their peak, not a time when he or she is interested in collective action or the need for caution.⁴¹³ A franchisee who thinks the deal is almost done may be afraid to make waves, or seem the wrong kind of franchisee, or one who does not expect to be successful, or he or she may want to avoid bargaining with a franchisor as a sign of trust and cooperation.⁴¹⁴

Also, disparities in legal representation can be part of the imbalance of power between franchisor and franchisee. Because they are typically inexperienced in owning and operating a business, franchisees need good legal advice, but often, they do not get it. A franchisee may not fully utilize the advice of counsel as this is a time when he does not want to hear about 'the downside'. Many franchisees are unaware of the need for

⁴¹¹ *Deloitte Franchisee Satisfaction Survey* (2004) Deloitte <http://www.deloitte.com/dtt/press_release/0,1014,sid%253D5527%2526cid%253D83960,00.html> at 15 August 2005. Franchising as a sector is predominantly 'small business', despite its significant contribution to the economy. Only a handful of the 800 or so franchise systems that operate in Australia are publicly listed companies on the ASX. According to the 2002 Franchise Council of Australia/Griffith Survey, few franchise systems show signs of structural and procedural corporatisation. Only a quarter of the businesses in the survey reported a company board of more than four members and fewer still have more than one external member or a franchisee appointed to the Board.

⁴¹² Interview with Adfectare representative, FCA Conference Melbourne (September 2003). Counsel for franchisors advise that prospective franchisees be required to sign a confidentiality agreement before being given the contract.

⁴¹³ These psychological conditions are discussed in Susanna Kim Ripken, 'The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation' (2006) 58 *Baylor Law Review* 139.

⁴¹⁴ George Dent, 'Lawyers and Trust in Business Alliances' (2002) 58 *Business Lawyer* 45.

or are unable to secure the quality of advice they need.⁴¹⁵ In contrast to franchisors, for whom many deals riding on the drafting of one contract make paying top dollar for legal advice a necessity, franchisees often feel that they cannot afford to spend much on legal advice. Even if a franchisee does understand, as a franchisor does, that the terms of the contract are crucial to the power in the relationship, a franchisee may lack sufficient resources to engage a solicitor with extensive experience in franchising, or one may not be available in the area, or if counsel experienced in franchising is available, he or she may well already act for a franchisor that creates a conflict of interest in representing that franchisee. Finally, assuming a franchisee were perspicacious and financially capable of hiring the best legal advice, the experienced and zealous solicitor acting for a franchisee may still find a franchisor intractable in contract negotiations, claiming the necessity for uniformity in all franchise contracts. Even the most prudent franchisee might fail to see the reason to allocate resources to negotiation of a contract that is not negotiable.

Many factors contribute to the inequality of bargaining power in a franchise relationship including franchisee inexperience, franchisee psychology and franchisee legal representation, as well as a franchisor's need to maintain strict control. While franchisors claim that franchisees can be more profitable and influential than franchisors themselves are, the weight of the evidence is that this is not typically the case. In fact, for the purposes of maintaining uniformity and control, to maintain the system standards and to limit the costs of externalities and transaction costs, many franchisors have an interest in keeping franchisees in a subordinate position throughout the relationship. This disparity in bargaining power exists not only at the time of negotiation of the contract, but persists throughout the relationship.

4.4.2 Summary of implications of the standard form

There is wide variation in forms of franchising. Not all franchises are business format franchises. They may change in nature as the franchise system develops. New franchise systems are qualitatively different in many ways from established systems; it may be that in a new franchise system a franchisor is not contractually or commercially significantly more powerful than a franchisee. Also, for established systems seeking to appoint multiple unit franchisees the bargaining power disparity

⁴¹⁵ Ibid.

may be less marked. Nevertheless, generally speaking, in business formation franchising, the imbalance of power in the relation from the outset, combined with the fact that franchise contracts are not negotiated, means that franchise contracts do satisfy the elements of the standard form contract.⁴¹⁶

In 1971 W. David Slawson estimated that, ‘Standard form contracts probably account for more than ninety-nine percent of all the contracts now made.’⁴¹⁷ Standard terms are credited with helping to ‘democratize the marketplace’ because they afford access to market interactions for participants who might otherwise be excluded. They also offer consistency and a degree of anonymity.⁴¹⁸ But the main reason the standard form contract is widely used is that it reduces transaction costs in several ways. First, using the same contract many times eliminates the cost of drafting new contracts for similar transactions. Second, standard form contracts reduce the cost of contract negotiations because they generally are not subject to negotiation. Third, and perhaps most significantly in the franchising context, the standard form contract helps to contain a franchisor’s administrative costs through the course of the performance of an agreement; the standard form ensures uniformity in a franchisor’s dealings with every franchisee. There is an obvious attraction of the standard form contract for a franchisor, therefore, in its relative expediency and low cost at the drafting and negotiation stages and in its containment of administration costs throughout the relationship.

Standard form contracts are enforceable. However, to the extent that the standard form deprives the contract of information exchange and consent, there may be no ‘meeting of the minds’. Consent becomes largely irrelevant; and ‘bargained-for

⁴¹⁶ A study by Francine Lafontaine underscores the uniformity in franchise contracts. In her work on franchise contract variation Lafontaine hypothesized that the contract would vary depending upon variables of risk, agent effort, outlet size, cost of monitoring, franchisor effort, spillovers within chains, and several other factors. She found, however, that contracts terms do not vary significantly for the tested variables. But all of the factors tested did impact upon the franchisors’ decision to franchise; that is the choice to integrate through a company-owned store or to segregate through a franchised outlet. See Francine Lafontaine and Margaret E. Slade, ‘Incentive Contracting and the Franchise Decision’ in Chatterjee, Kalyan and William F. Samuelson (eds), *Game Theory and Business Applications* (2001) 162-168.

⁴¹⁷ John J. A. Burke, ‘Reinventing Contract’ (2003) 10(2) *Murdoch University Electronic Journal of Law* [22] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003; also W. David Slawson, ‘Standard Form Contracts and Democratic Control of Law Making Power’(1971) 84 *Harvard Law Review* 529, 529.

⁴¹⁸ John J. A. Burke, ‘Reinventing Contract’ (2003) 10(2) *Murdoch University Electronic Journal of Law* [46] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003.

exchange', once considered an essential element of a valid contract, is lost. Deprived of the many benefits of the negotiation and consent, the contract becomes less reliable as an accurate reflection of the intentions of both parties; the standard form contract becomes a vehicle for the exploitation of unequal power relations and may encourage the imposition of unjust and/or inefficient terms. Ultimately, these conditions can negatively impact parties' willingness to perform. Some even suggest that because there is no meeting of the minds and no valid consent, the standard form contract is not a contract at all and that enforcement is not justified.⁴¹⁹

In the absence of bargained-for-exchange and negotiation, contract loses its function as a process. Burke asserts that the standard form contract is not so much a means of governance as a commodity.⁴²⁰ The contract becomes part of the product franchisor is selling. Though formal rules of interpretation are applicable in the context of the standard form, formal rules for determining validity such as offer, acceptance and consideration, are less relevant because contract has become product rather than process. A franchisee's role is analogous to that of a consumer with a need for consumer protections. Courts and regulators, however, still treat commercial transactions such as the franchise contract as business relations between equals, and so no such protection is afforded. The role of a franchisee is analogous to that of a consumer, but the regulatory approach is structured more toward a business and investor relationship.

Collins has argued that the standard form need not cause problems in regulation.⁴²¹ He claims that contract is highly reflexive, and, though he acknowledges that this reflexivity caters solely to the needs of drafter, he claims that the qualities of the standard form are counter-balanced by markets for terms, markets for fair dispute resolution procedures, unfair contracts legislation,⁴²² and democratic self-regulation within market sectors. This research indicates, however, that the factors that Collins suggests save the standard form from the dangers of abuse are absent in the franchise context in Australia. While Collins asserts that the standard form is not a problem if

⁴¹⁹ John J.A. Burke, *Standard Form Contracts* (2004) Lex2k
<<http://www.lex2k.org/sfc/discussion.html>> at 28 October 2006.

⁴²⁰ Ibid.

⁴²¹ Hugh Collins, 'Regulating Contract' in C. Parker et al (eds), *Regulating Law* (2004).

⁴²² Hugh Collins, 'Regulating Contract' in C. Parker, C. Scott, N. Lacey and J. Braithwaite (eds), *Regulating Law* (2004) xxxv.

there are markets for terms and for fair dispute resolution procedures; there is neither in the franchising sector in Australia. He suggests that problems that do persist will be addressed by unfair contracts legislation, but there is no such legislation at the federal level or in most states in Australia. Collins also recommends greater reliance on democratic self-regulatory mechanisms within market sectors, but such mechanisms are non-existent in the franchising sector, and any efforts that have been made to establish them have been defeated. Collins acknowledges this when he notes that a franchisee's power to use non-legal sanctions, for example, to damage reputation of franchisor, is lacking.⁴²³

Standard form contracts do present special problems, and these problems are heightened when the standard form contract is also a relational one. Collins also takes an overly sanguine view of the use of the standard form in franchising when he neglects to acknowledge the importance of the synergistic effects of the standard form combined with relational contract characteristics. The combined effect is that the parties' self-regulation through contract fails to advance the goals of regulation. On the contrary, it is instrumental in creating these problems, and it reinforces them.

4.4.3 The franchise contract as a relational contract

Classical contract theory emphasizes the freedom of parties to contract, underscoring societal values of individualism and self-determination. There is, however, a body of research on the inadequacy of classical contract theory to address commercial relationships of extended duration.⁴²⁴ Such extended contractual relationships may be labelled relational, incomplete or long-term contracts. Various terms are used because there is a multiplicity of relationships and circumstances in which such contracts are used, and because there has as yet been no definitive synthesis of the ongoing research in this area. Terms that were used interchangeably are now evolving to have more particularized meaning as this field of research develops.

⁴²³ Hugh Collins, *Regulating Contracts* (1999) 244.

⁴²⁴ For an outline of the development of this area of scholarship see Erich Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures between Contract and Corporation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 67, 78-90.

In 1981 Goetz and Scott wrote that long-term 'relational contracts' bind parties who are independent rather than integrated within a firm.⁴²⁵ This is similar to the relational or behavioural contract described by Williamson and discussed in Chapter Three. Such contracts may be referred to as complex, status, behavioural, hybrid, symbiotic, relational, long-term and/or incomplete contracts, with each writer supplying his or her own particular approach and emphasis.⁴²⁶ As the terms standard form contract and contract of adhesion are sometimes used interchangeably, so too are the terms relational contract, incomplete contract and long-term contract. Whichever term one prefers, most contracts are not spot transactions; it is the relational contract that now prevails over the discrete contract in research about commercial interaction.

Though technically long-term contracts need not be relational, long-term contracts are usually relational contracts.⁴²⁷ Hviid, in his analysis and summary of relational and long-term contracting theory, quotes the early work of Schwartz to the effect that '[t]wo features largely define what lawyers mean by a relational contract: incompleteness and longevity.'⁴²⁸ The correlation between longevity and incompleteness is that the longer the term of the contract, the harder it becomes to predict all the conditions, preferences and requirements of the parties. Contracts are incomplete when they fail to outline all the possible situations in the course of dealings of the parties, thus creating gaps where the parties' obligations are not specified,

'A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of inability to identify uncertain future conditions or because of inability to characterize complex adaptations

⁴²⁵ Charles J. Goetz and Robert E. Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1089.

⁴²⁶ Economists and lawyers also ascribe different meanings to the term 'incomplete contract'.

⁴²⁷ While the distinction between the long-term and relational contracts may be important in some applications, it is beyond the scope of this paper to address the confusion in the use of the two terms. For more on the difference between relational and long-term contracts, and for an overview of the constitutive elements of each, see Morten Hviid, 'Long-Term Contracts and Relational Contracts' in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics Volume II: The Regulation of Contracts* (2000) 46 <http://esnie.u-paris10.fr/pdf/textes_2002/Hviid2000.pdf> at 4 November 2006. See also Charles J. Goetz and Robert E. Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1089.

⁴²⁸ Alan Schwartz, 'Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies' (1992) 21 *Journal of Legal Studies* 271.

adequately even when the contingencies themselves can be identified in advance.⁴²⁹

This leaves courts to decide whether to enforce the contract, and in what ways to fill gaps with default obligations.⁴³⁰ Relational contracts must balance the need for specificity and control against the need to accommodate uncertainty through the use of flexibility, discretion, reciprocity, and contextual interpretation.⁴³¹

According to Hviid's definition, franchise contracts are relational. They extend over a long period, commonly five, ten and sometimes twenty years. Many aspects of the relationship between franchisor and franchisee, including motivation and commitment, change over time. Such contracts cannot provide for every contingency during the period over which the contract extends; they are necessarily incomplete.⁴³²

A review of the literature suggests that in addition to incompleteness and longevity, there are some several fundamental characteristics that are commonly found in relational contracts. These characteristics are that relational contracts are flexible; that they cultivate trust through reciprocity of obligation; and that they require contextual interpretation.

4.4.3.1 Flexibility

Relational contracts are flexible. The benefit of flexibility is that it accommodates uncertainty, but relational theory holds that because parties cannot plan and allocate risks optimally in relational exchange, the contract is less accurate in documenting the

⁴²⁹ Charles J. Goetz and Robert E. Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1091.

⁴³⁰ See Robert E. Scott and George G. Triantis, 'Incomplete Contracts and the Theory of Contract Design' (Working Paper No 23, University of Virginia, 2005). According to Scott and Triantis, 'The incompleteness of a contract has a different meaning to an economist than to a lawyer: ... Economists use incompleteness in a different sense. A contract is incomplete if it fails to provide for the *efficient* set of obligations in *each* possible state of the world. Such a contract is "informationally incomplete" even though it is "obligationally complete" in the sense that it does not contain any gaps. Suppose that, in return for a payment of \$10 000, the seller promises to deliver a blue widget to the buyer on a specified date. As just noted, this contract is obligationally complete. But if there are circumstances in which the widget costs more to produce than it is worth to the buyer, the performance of this contract is inefficient. Thus, the contract is incomplete in the economic sense.'

⁴³¹ For more on the calculus of *ex ante* vs *ex post* contracting costs see Ian Ayres and Robert Gertner, 'Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules' (1992) 101 *Yale Law Journal* 729.

⁴³² Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927. Professor Hadfield wrote that the franchise contract is incomplete because of the 'uncertain and long-term nature of the relationship' and because it 'fails to address a franchisee's problem of controlling franchisor opportunism.'

parties' intentions and so detracts from the efficacy of contract.⁴³³ Contracting as an incremental process where parties agree as they proceed means that the contract when formed cannot reflect a true meeting of the minds. According to Schanze, the term 'long-term contract' was once considered to be an oxymoron. Because by its very nature, contract is restrictive, Sauvigny believed parties would be reluctant to subject themselves to obligations on a long-term basis.⁴³⁴

People do, however, enter contracts that involve relations over periods of years, and though practitioners draft contracts as specifically as possible, contract cannot anticipate every contingency in a long-term association such as franchising.⁴³⁵ Parties do not know what conditions will be in five or ten years; even if they did, they might not know how they would respond to them. Specific and rigid contract terms are incompatible with the flexibility necessary to maintain the parties' relationship; they therefore include in their contracts flexibility and elements of discretion.⁴³⁶ One or both parties must sacrifice efficiency and certainty for the unpredictable exigencies of the longer-term relationship.⁴³⁷

⁴³³ See Weber on the status contract as opposed to the purpose contract; Macneil on the relational context of contractual relations in Ian R. Macneil, 'Relational Contract: What We Do and Do Not Know' (1985) *Wisconsin Law Review* 483; Macaulay on the insufficiency of classical contract theory as applied to long-term business relationships in S. Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' in Campbell, David, Collins, Hugh and Wightman, John (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 51; Schanze on symbiotic contracts in Erich Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures between Contract and Corporation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 67; Stipanowich on dispute resolution and "the multi-door contract" in Thomas J. Stipanowich, 'The Multi-Door Contract and Other Possibilities' (1998) 13 *Ohio State Journal on Dispute Resolution* 303; as well as earlier writings of Sauvigny (1851) and von Gierke (1914).

⁴³⁴ Erich Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures between Contract and Corporation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 67.

⁴³⁵ This inherent contradiction, that contracts are essentially about commitment, but that long-term contracts require flexibility over time explains why Sauvigny believed the term 'long-term contract' to be an oxymoron. See Erich Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures between Contract and Corporation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991).

⁴³⁶ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 316.

⁴³⁷ See Charles J. Goetz and Robert E. Scott, 'Principles of Relational Contracts' (1981) 67 *Virginia Law Review* 1089, 1091: 'A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of the inability to identify uncertain future conditions or because of inability to characterize complex adaptations adequately even when the contingencies themselves can be identified in advance.'

As a practical matter, the use of the relational contract, like that of the standard form, is motivated largely by transaction costs. The information costs of contracting can be divided into *ex ante* transaction costs that include the costs of anticipating future contingencies and writing a contract that specifies outcomes, and *ex post* enforcement costs that include the costs of monitoring and enforcement. In seeking to avoid both *ex ante* and *ex post* contracting costs, contracting parties write incomplete contracts.⁴³⁸ Such contracts reduce transaction costs because they provide an efficient strategy for contracting parties to accommodate the relational conditions of incompleteness and longevity. Relational contracts economize on the *ex ante* negotiation of terms and permit the parties to determine the contours of the agreement incrementally over time.

In franchising, however, the nature of the relationship and the use of the standard form combine with the relational incompleteness so that virtually all the power to determine the contours of the relationship over time resides with a franchisor. A franchisee's role is to agree in advance to go along. The contract terms are written to add up to this, but sometimes there is even a term that explicitly so states.⁴³⁹ As Schanze comments, the line must be drawn somewhere between 'tolerable duration and dependency' and 'illegal restraints and ties.'⁴⁴⁰ Goddard observed that a relational contract may be more effective where the contract contains reciprocal commitments to help develop trust.⁴⁴¹ Symmetry in discretion permits the parties to balance threats of opportunism and free-riding on each side.⁴⁴² Symmetry in discretion, however, is not a common feature of franchise contracts. Discretion as an element of franchise contracts will be discussed in more detail in Chapter Five.

⁴³⁸ See Robert E. Scott and George G. Triantis, 'Incomplete Contracts and the Theory of Contract Design' (Working Paper No 23, University of Virginia, 2005).

⁴³⁹ The collective agreement clause, aka a 'go along' or 'agree to agree' clause.

⁴⁴⁰ Erich Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures between Contract and Corporation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 67, 86.

⁴⁴¹ David Goddard 'Long-Term Contracts: A Law and Economics Perspective' [1997] *New Zealand Law Review* 423.

⁴⁴² Franchisee gives despite risks to franchisee of opportunism of franchisor hold-ups (demands for additional payments in exchange for consent). The franchisor, if opportunistic, risks franchisee's exit (relying on express or implied terms) but this is partly balanced by franchisee's reluctance to forfeit sunk costs and transaction costs. See Hugh Collins, 'Discretionary Powers in Contracts' in David Campbell, Hugh Collins and John Wightman (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 226-231.

4.4.3.2 Reciprocity

Reciprocity is another essential aspect of the relational contract.⁴⁴³ Relational contracts are designed to allow the parties latitude to maintain a dynamic balance between their shifting interests. In a discrete contract the subject matter of the contract is relatively independent of the parties' relationship. In a relational contract the subject matter of the contract is the relationship. One party taking unfair advantage in the negotiation or performance of the contract has the potential to undermine the relationship. While the opportunistic party may believe it is making a better deal for itself, it may also sacrifice reciprocity and erode trust.

The role of the relational contract then is not to precisely define the rights and obligations of the parties, but to provide the framework, procedures and the points of departure for fair contract negotiation and adjustment over time. The fundamental nature of relational contracts is therefore inconsistent with the standard form because, unlike the strict formality required by the standard form, relational contracts support 'the primacy not of the narrow contract provisions but of the wider franchising relationship'.⁴⁴⁴

4.4.3.3 Contextual interpretation

Courts have been slow to acknowledge relational contracts. The legal nature of a franchise contract was considered in the New Zealand High Court. In a dispute involving the Australian Dymock's franchise system, Hammond J held that a franchise agreement represents an ongoing relationship, and that it is a relational contract rather than a simple bilateral contract.⁴⁴⁵ The significance of such a designation, however, is not entirely settled, 'While the categorisation of franchising as a relational contract seems straightforward, the legal consequences that follow from the categorisation are highly controversial.'⁴⁴⁶ The proceedings of a contract law symposium held in 2005 began by noting that,

⁴⁴³ Ian R. Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under the Classical, Neo-classical, and Relational Contract Law' (1978) 72 (6) *Northwestern University Law Review* 854.

⁴⁴⁴ Andrew Terry, 'Franchising, Relational Contracts and the Vibe' (Paper presented at the International Society of Franchising 2004 Conference, Las Vegas, 6-7 March 2004) 1.

⁴⁴⁵ *Bigola Enterprises Ltd v Dymocks Franchise Systems (NSW) Pty Ltd* [2003] 3 NZLR 169.

⁴⁴⁶ Andrew Terry, 'Franchising, Relational Contracts and the Vibe' (Paper presented at the International Society of Franchising 2004 Conference, Las Vegas, 6-7 March 2004) 4.

‘Few developments in contracts scholarship in the past half-century have been more influential than relational contract theory. Perhaps no other recent movement has seeped so deeply into the way we think of and discuss contract law than the notion that the things we think of as ‘contracts’ are rooted in larger relationships, and cannot be understood apart from those relationships...it is also fair to say that no other movement has managed to take so many different forms.’⁴⁴⁷

Another commentator writes,

‘Relational theory is not that useful...it is impossible to locate, in the relational contract literature, a definition that adequately distinguishes relational and non-relational contracts in a legally operational way – that is in a way that carves out a set of special, well-specified contracts for treatment under special, well-specified rules...’

Relational contracts accommodate uncertainty by leaving terms unspecified and providing high levels of discretion. Because they grant discretion and freedom, these documents often fail to provide clear and specific answers in case of dispute. Relational contract theory holds that every transaction is embedded in complex relations, and that combined contextual analysis of relations and transactions produces a more complete and accurate analytical product.⁴⁴⁸ This may be little comfort to a judge seeking to arrive at such an ‘analytical product’.⁴⁴⁹ Courts may be reluctant to embrace a theory that highlights the importance of the context of the relationship because context can be challenging to discern, especially in the case of franchising due to the difficulties in obtaining reliable information.⁴⁵⁰

⁴⁴⁷ Franklin G. Snyder (ed), ‘Symposium: The Common Law of Contracts as a World Force in Two Ages of Revolution: A Conference Celebrating the 150th Anniversary of Hadley v. Baxendale’ (2005) 11(2) *Texas Wesleyan Law Review* 675, 675-676.

⁴⁴⁸ ‘Relational Contracting in a Digital Age’ (2005) 11(2) *Texas Wesleyan Law Review* 675, 675–676. Panel Discussion at the Central Gloucester Initiative: The Common Law of Contracts as a World Force in Two Ages of Revolution, Gloucester, England, 7–8 June 2004.

⁴⁴⁹ The solution Hadfield proposed was that courts should imply a term of good faith in franchise contracts. The interpretation of good faith in franchise contracts is discussed in Chapter Seven.

⁴⁵⁰ Melvin Aron Eisenberg, (1995) ‘Relational Contracts’, in Beatson, Jack and Friedmann, Daniel (eds), *Good Faith and Fault in Contract Law*, Oxford, Clarendon at 291 – in the Hviid article at [58] Morten Hviid, ‘Long-Term Contracts and Relational Contracts’ in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics, Volume III. The Regulation of Contracts*, (2000) [631] <http://esnie.u-paris10.fr/pdf/textes_2002/Hviid2000.pdf>.

4.5 THE INTERACTION OF STANDARD FORM AND RELATIONAL CONTRACTING

The qualities of standard form and relational contracts both have been discussed in the legal academic literature, but they are discussed separately.⁴⁵¹ The franchise contract presents an instance where these two contractual qualities co-exist. This research is the first to examine the synergistic impacts of the standard form and relational qualities of the franchise contract. It identifies six important effects of the interaction.

First, the power imbalance of the standard form combined with the reliance on trust and reciprocity of the relational contract lead to increased inequality of bargaining power. The drafter of the contract has power, while the non-drafting party must rely on trust, reputation and other means outside the contract. The relational contract is about creating a framework for trust and reciprocity, but trust may be undermined if the standard form gives inordinate discretion to drafter, depending on how that discretion is ultimately exercised.

Second, the lack of negotiation of the standard form plus the flexibility, discretion, and vaguely defined obligation characteristic of the relational contract create a risk of inefficient risk-shifting. The drafting party of the standard form contract can accord flexibility to itself, while imposing specified obligations upon the other. Where a contract is relational and standard form, the drafting party can manage risk through contract, but the other party cannot.

Third, it is a defining characteristic of the standard form that the drafter enters many contracts, while the non-drafting party contracts relatively infrequently. Added to this are the inherent contradictions in approaches to interpretation of the relational contract, as it involves close interaction where the agreement takes shape over time through ongoing negotiation between the parties. The result is that the standard form and relational conflict; the relationship cannot take shape over time, except according to the specific dictates of the drafting party.

Fourth, a focus on formation of the standard form as opposed to a focus on performance of the relational quality of the contract creates a dilemma for regulators.

⁴⁵¹ For an article that touches on the interaction in the management literature, see L. Poppo and T. Zenger, 'Do Formal Contracts and Relational Governance Function as Substitutes or Complements?' (2002) 23 *Strategic Management Journal* 707.

Regulation (and to lesser extent court interpretation) tends to focus on contract formation with the result that the relational qualities lose meaning. Thus, the interaction of the standard form and relational contract characteristics create problems in regulating caused by the conflicting emphasis on formation versus performance of the contract.

The fifth point is closely related to the fourth; formal interpretation required by the standard form conflicts with contextual interpretation appropriate to a relational contract. These two different types of contract call for inconsistent approaches to interpretation and enforcement of the contract. Here again, the standard form prevails; formal rules and express contract terms (a franchisee often does not understand because it did not draft or negotiate) trump contextual interpretation.

Sixth, the ‘contract as commodity’ of the standard form as opposed to ‘contract as relationship’ of the relational quality of the franchise contract creates another conflict where the standard form prevails. The non-drafting party takes on qualities of consumer of product, rather than an equal party to negotiation of terms.

This chapter focuses on the first four of these synergistic effects as they are manifest in the franchise relationship. These are represented in the following Table 4.2 and explained in more detail in the sections following the table.

Table 4.2: Interaction of Standard Form and Relational Contract Characteristics

Standard form contract characteristic		Relational contract characteristic		Result
Imbalance of Power and no negotiation of contract	+	Gaps and terms where there is future uncertainty , flexibility requires discretion, vaguely defined obligation	=	High levels of uncertainty for a franchisee. A franchisor can manage risk through contract, by according discretion to itself and uncertainty to its franchisees. Because a franchisee is not able to participate in the drafting or negotiation of the contract, a franchisee cannot. A franchisor accords flexibility to itself, with specified obligations imposed upon a franchisee.
Drafter enters many contracts, non-drafting party contracts infrequently	+	Involves close interaction, agreement takes shape over time as ongoing negotiation between the parties	=	Standard form and relational conflict because the relationship cannot take shape over time, except according to the specific dictates of the drafting party.
Contract as commodity	+	Contract as relationship	=	A franchisee takes on qualities of consumer of product, rather than an equal party to negotiation of terms.
Power imbalance	+	Reliance upon trust, reciprocity	=	A franchisor is assured of discretion written into the contract terms while a franchisee must rely on trust, reputation and other factors outside the contract. Trust, however, can be compromised by the standard form discretion to franchisor, if a franchisor does not act in a franchisees' interest, a problem due to the inherent conflicts of interest in the relationship.

4.5.1 Loss of bargained-for-exchange

Independently of each other, both the standard form and the relational qualities of the contract erode the element of bargained-for-exchange. First, the standard form is characterized by an imbalance of power and lack of negotiation of contract; there is no 'promise for a promise'. The standard form thus deprives the parties of complete understanding of contractual terms because it eliminates negotiation. The lack of a negotiated process for arriving at agreed terms makes the standard form susceptible to abuse for the purposes of imposing onerous terms upon a franchisee that a franchisee might not fully understand or to which it does not genuinely consent, '[Franchise contracts] contain provisions which are extremely difficult for franchisees to comply with. The result is that franchisees are constantly in peril of non-compliance.'⁴⁵²

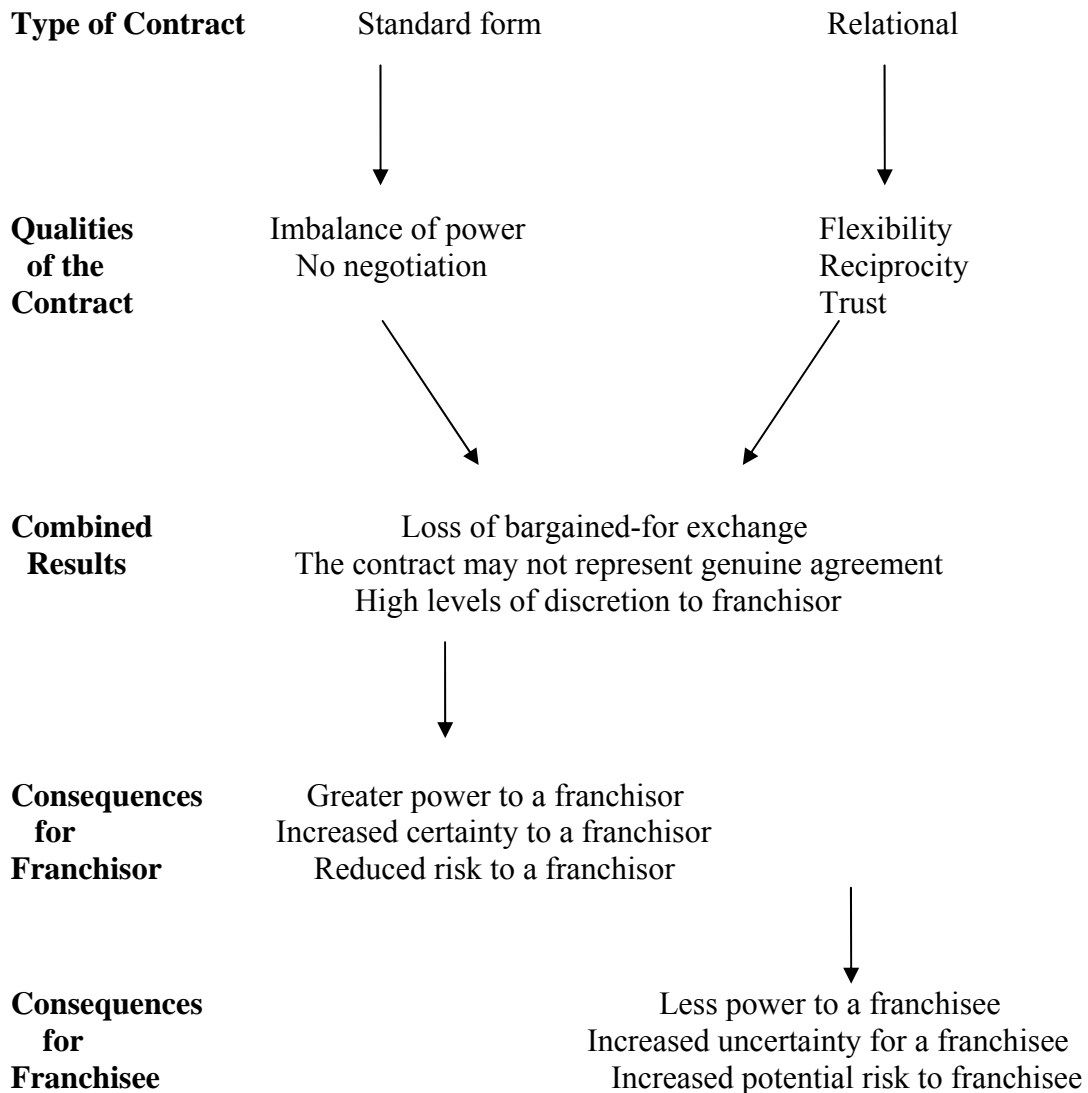
The relational contract is about accommodating uncertainty by building in flexibility, reliance upon trust, and contextual interpretation. Relational contracts further erode the bargained-for-exchange because parties must leave the terms of the contract unspecified to accommodate uncertainty. Where the relational contract is also a standard form contract, where a franchisor drafts the contract but does not negotiate, flexibility is given not reciprocally, but to one party, a franchisor. The franchise contract, as it is both standard form and relational, accords the weight of its flexibility and discretion to a franchisor.

The result is that the standard form and relational characteristics of the contract synergistically deprive the franchise contract of the essential element of bargained-for-exchange. The interaction of the two qualities means that a franchisor can take on greater risk and manage risk effectively through drafting and contractual risk-shifting, while a franchisee is not similarly able to manage risk through contract. A franchisee is faced with the choice to unqualifiedly accept the risk assigned to it by a franchisor's contract or to decline to enter the relationship altogether. The loss of bargained-for-exchange thus erodes the meaning of the contract for a franchisee and can reduce its commitment to perform. This is true under conditions that are likely to test that commitment; high levels of discretion to a franchisor mean power to a franchisor to

⁴⁵² California Supreme Court Justice Stanley Mosk in a concurring opinion in *E.S. Bills Inc. v. Tzucanow* quoted in James V. Jordan and Judith B. Gitterman, 'Franchise Agreements: Contract of Adhesion?' (1996) 16 *Franchise Law Journal* 1, 41.

act in its own interests and concomitantly low levels of power and high levels of uncertainty to a franchisee as depicted in Figure 4.1 below:

Figure 4.1: The Interaction of the Standard Form and Relational Qualities of Contract



The erosion of bargained-for-exchange diminishes fundamental precepts of contract law such as consent and intention; leads to high levels of uncertainty for a franchisee as non-drafting party due to its combination with the relational contract's flexibility; and contributes to the 'commodification' of contract, in which a franchisee takes on qualities of consumer of product, rather than an equal party to negotiation of terms.⁴⁵³

⁴⁵³ John J. A. Burke, 'Reinventing Contract' (2003) 10(2) *Murdoch University Electronic Journal of Law* [51] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003.

4.5.2 Franchisor discretion increases uncertainty and risk for a franchisee

Transaction costs saved in drafting and negotiation of a standard form contract can mean heavier transaction costs in monitoring performance, dispute management and liability. This cost trade-off is of particular concern where the standard form is combined with relational contracting and performance obligations may be more flexible, thus adding to uncertainty. One way franchisors address this problem is to require sunk investments by franchisees. Another way is to draft the contract to strictly specify franchisee obligations while retaining flexibility in their own obligations. High levels of discretion to a franchisor mean that there are high levels of uncertainty for a franchisee, uncertainty that increases franchisee risk and undermines franchisee power, increasing the power imbalance.

4.5.3 Motivations for granting discretion

Imbalance of power and high levels of uncertainty contribute to increased discretion to the drafting party; the converse is in theory also true. Because discretion is itself the ability to exercise power, greater discretion to one party does increase the imbalance of power. Where one party has the discretion to determine the parties' future interactions, uncertainty is increased for the granting party. The motivations for a contracting party to give discretion in contract include accommodating future uncertainty and securing lower costs, price breaks, and economies of scale.⁴⁵⁴ These and other potential benefits may make the decision to accord discretion to another party a reasonable one. In franchising, however, the existing imbalance of power and lack of negotiation of the standard form generate pressure on a franchisee to give discretion to a franchisor. In addition, many of the same factors that contribute to a franchisee's disadvantage in negotiating the contract contribute to a franchisee's willingness to take on risk, namely inadequate franchisee legal representation, strict franchisor control, and a franchisee's lack of confidence.

The first factor in increasing the pressure on a franchisee to accept risk is the disparity in legal representation. Lawyers representing sellers shift risks in contract to

⁴⁵⁴ Hugh Collins, 'Discretionary Powers in Contracts' in David Campbell, Hugh Collins and John Wightman (eds), *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (2003) 26-231.

buyers.⁴⁵⁵ Franchisor's solicitors include terms they know or suspect would not be enforceable because a franchisee is likely to believe that they are enforceable and/or because such clauses may be useful to a franchisor in conflict management.⁴⁵⁶ Risk to a franchisor is minimal due to the low probability that the issue will lead to litigation. A busy franchisor may not even be aware of the problem or it may be that he or she leaves these concerns to a solicitor. The contract comes to represent not so much a franchisor's business judgment and experience, but rather a franchisor's solicitor's skill and zeal in shifting risk to a franchisee. The potential result is that the contract is no longer an instrument of the true intentions of either a franchisor or a franchisee. A franchisee's contractual intention may be 'but a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood only in a vague way, if at all.'⁴⁵⁷ Adding to the pressure on franchisee to accept more risk is a franchisor's rigid protection of its control and discretion for the sake of its ability to enforce uniform standards.

Another reason a franchisee may take on too much risk is lack of confidence. Franchisee subordination to a franchisor helps to assure cooperation within the franchise system. This phenomenon is referred to by Lescatre and Steinberg as the 'infantilization' of a franchisee.⁴⁵⁸ In the same vein Hadfield observed,

'The presumed, and preferred, inexperience of the franchisee introduces the reliance of the franchisee on the franchisor into the very heart of the franchise relationship. This imbalance is not just a consequence of imperfections in bargaining. Rather, it is in the very nature of what is being exchanged.'⁴⁵⁹

The inherent dynamic in franchise relationship involves maintaining a franchisee in a subordinate position. Its subordinate position increases a franchisee's motivation to provide assurances of performance; taking on risk. Thus, unequal bargaining power invites risk-shifting. Even if it is overburdened with risk because of the standard form, a franchisee is faced with the choice of accepting the contract terms or giving

⁴⁵⁵ John J. A. Burke, 'Reinventing Contract' (2003) 10(2) *Murdoch University Electronic Journal of Law* [51] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003.

⁴⁵⁶ Ibid.

⁴⁵⁷ Friedrich Kessler, 'Contracts of Adhesion--Some Thoughts about Freedom of Contract' (1943) 43 *Columbia Law Review* 629, 632.

⁴⁵⁸ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 185.

⁴⁵⁹ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 962

up on the deal entirely. These factors increase the shifting of risk from a franchisor to a franchisee, often without a franchisee being fully aware of it. In the context of franchising, while benefits can be obtained from according discretion to a franchisor, the balancing of costs and benefits may not be adequately carried out, if it is undertaken at all by a prospective franchisee. The contract may go forward with a franchisee in reluctant or uncertain agreement to its terms, and once it does, a franchisor's discretion is locked in. A franchisee takes on high levels of uncertainty that increase its exposure to risk and increase the imbalance of power in the relationship.

4.6 A NOTE ON THE EFFICIENT ALLOCATION OF RISK

While it would be tempting to refer to this issue as inefficient shifting of risk, this dissertation does not address the efficiency of risk allocation. It is not proven that discretion, and the imbalance of power and uncertainty that attend it, must necessarily disadvantage the granting party.

A variety of formulations for the concept of efficiency of contract have been proposed by economists. Weber and Xiong suggest that in an efficient contract, the aggregate benefits to principals and agents (excluding consumers) are maximized.⁴⁶⁰ This would be a difficult formula to test, and consideration of consumers which is an important aspect of a franchisee's role is excluded. Alternatively, an efficient contract could be defined as one that provides optimal incentives for both investment and trade; 'an efficient contract should contain incentives to encourage efficient effort and/or investment.'⁴⁶¹ Not only is this definition circular, it is also general and difficult to measure. Borrowing from the law and economics view of efficient breach of contract, a contract may be inefficient when the cost to the promisor of performance exceeds the value to the promisee.⁴⁶² This, too, is difficult to measure, even in terms of pure economic benefit, and impossible to measure taking into account all the possible non-economic motivations for entering franchise contracts. Yet another approach that has been proposed is that, 'Contracts are efficient when

⁴⁶⁰ Thomas A. Weber and Hongxia Xiong, *Efficient Contract Design in Multi-Principal Multi-Agent Supply Chains* (2006).

⁴⁶¹ Bruce R. Lyons, 'Empirical Relevance of Efficient Contract Theory: Inter-firm Contracts' (1996) 12(4) *Oxford Review of Economic Policy*. Lyons does not define 'efficient effort and investment'.

⁴⁶² Robert E. Scott and George G. Triantis, 'Incomplete Contracts and the Theory of Contract Design' (Working Paper No 23, University of Virginia, 2005).

they properly align incentives; a good contract design is one that allows managers to raise capital cheaply and deploy it effectively'.⁴⁶³ This formulation combines elements of encouraging effort and investment, providing incentives and balancing costs, but it is a formula that is also vague and difficult to measure and does not take into account the franchisee side of the equation.

Law and economics explores the efficiency of contract in the case of breach and the efficiency of default rules in court interpretation of contracts. It is a harder task to determine what is 'efficient' in connection with contract generally, as in the formation or performance of contract, because one must first choose from among a multiplicity of competing theories of what contract is intended to do in any given context. Courts wrestle with this problem, often relying on formal rules with respect to contract formation and on default rules and theories of relational and incomplete contracting with respect to performance.

It is perhaps understandable that 'many economists are uncomfortable with the efficiency arguments of law and economics.'⁴⁶⁴ Though the Chicago School of law and economics rests on the concept of allocative efficiency, it is precisely its conceptions of 'efficiency as justice' that 'many of the critics of the Chicago approach find so troubling.'⁴⁶⁵ The institutional approach to law and economics rejects efficiency as a criterion for the assignment of rights, and instead holds that,

'Because efficiency is a function of rights, and not the other way around, it is circular to maintain that efficiency alone can determine rights...an outcome that is claimed to be efficient is efficient only with regard to the assumed initial structure of rights.'⁴⁶⁶

The choice of rights, however, is a distributional issue. Ultimately, efficiency cannot be separated from distributional issues, 'the legal system must select the [distributional] result to be pursued: the definition of the efficient solution is both the object and the subject of the legal system.'⁴⁶⁷

⁴⁶³ Victor Fleisher, 'Brand New Deal: The Branding Effect of the Corporate Deal Structures' (2006) 104 *Michigan Law Review* 1581, 1583.

⁴⁶⁴ Paul H. Rubin, 'Micro and Macro Legal Efficiency: Supply and Demand' (2005) 13 *University of Chicago Supreme Court Law Review* 19, 20.

⁴⁶⁵ Nicholas Mercurio and Steven Medema, *Economics and the Law* (1997) 60-61

⁴⁶⁶ *Id.*, 118.

⁴⁶⁷ *Id.*, 119, includes a quote from Warren J. Samuels, 'Normative Premises in Regulatory Theory' (1978) 1 *Journal of Post-Keynesian Economics* 100, 106.

One meaning of ‘efficient’ is ‘performing or functioning in the best possible manner with the least waste of time and effort...’⁴⁶⁸ It is beyond the scope of this dissertation to consider all the competing theories of what contracts do or should do, or how they can function in the best manner with least waste. Many commentators would agree, however, that a contract should give effect to the intentions of the parties. In the case of the standard form, relational interaction, the potential for contractual efficiency is decreased due to the fact that one party to the contract is ill-equipped to understand the nature of the contract and the relationship. To the extent that this is so, the contract does not represent the true consent of the parties to its terms. The contract does not do what it is intended to do, and in this sense it is an inefficient contract. It would seem to follow that the risk allocation in a franchise contract is inefficient if it is not fully understood and consented to by a franchisee.

Because of the complexity of the topic of efficiency of contracts, this dissertation omits any further reference to the question of efficiency in the allocation of risk in the contract, and returns its focus to the question of whether regulation of franchising is effective at achieving its stated goals.

4.7 CHAPTER CONCLUSION

Chapter Four describes two important attributes of the contract, its standard form nature and its relational features. This chapter demonstrates that, independently of each other, the standard form and the relational qualities of the contract contribute to imbalance of power and uncertainty. The characteristics of the standard form reflect and reinforce an imbalance of power in the franchise relationship. The relational contract is one of flexibility and discretion; it relies on trust and reciprocity over the long-term. Relational contracts require incompleteness and flexibility in order to accommodate unpredictable conditions and preferences over the performance of the contract. While the standard form and relational attributes of the franchise contract independently contribute to the imbalance of power and the uncertainty in the relationship, the interaction of the two qualities exacerbates these conditions.

To understand franchising, and so to appropriately regulate, it is essential to recognize that the interaction of the standard form and relational qualities of the contract has the

⁴⁶⁸ *Dictionary.com Unabridged (v 1.0.1)*. Based on the Random House Unabridged Dictionary, © Random House, Inc. Dictionary.com <<http://dictionary.reference.com/browse/efficient>> at 2 October 2006.

following effects that together increase imbalance of power and uncertainty. First, the power imbalance of the standard form combined with the reliance on trust and reciprocity of the relational results in increased inequality of bargaining power. A franchisor has power, while a franchisee must rely on trust, reputation and other factors outside the contract. Second, the lack of negotiation of the contract of the standard form combined with the flexibility, discretion, and vaguely defined obligation required by the relational quality of the franchise contract mean that a franchisor accords flexibility to itself, while at the same time it imposes specific obligations upon franchisees. Thus, uncertainty for a franchisee is increased. A franchisor can manage risk through contract, but a franchisee cannot. Third, the ‘contract as commodity’ approach of the standard form as opposed to a ‘contract as relationship’ approach of the relational quality of the franchise contract creates another conflict where the standard form prevails. A franchisee takes on qualities of consumer of product, rather than an equal party to negotiation of terms.

The market interaction establishes imbalance of power and uncertainty in the franchise relationship. The nature of the franchise contract reinforces these conditions. Chapter Five will consider contract terms and whether they reflect the imbalance of power and uncertainty that will in theory exist in franchise contracts, or whether they reflect the effectiveness of regulation in addressing these conditions.

4.8 CHAPTER SUMMARY AND RECOMMENDATIONS

Chapter Four examined the parties’ self-regulation of the relationship through contract and it explained why the standard form and relational qualities of the franchise contract increase uncertainty and imbalance of power. The main points and recommendations are as follows:

- The standard form contract by definition creates an imbalance of power in the contracting relationship in favour of a drafter of the contract, a franchisor. The standard form contract tends to impose higher levels of uncertainty and risk for the subordinate party, a franchisee.
- Relational contracts contribute to imbalance of power in favour of a franchisor because a franchisor has a higher level of discretion to accommodate future uncertainty, and higher levels of trust are placed by a franchisee in a

franchisor. Relational contracts contribute to uncertainty for a franchisee because conditions of the agreement are not specified.

- Together, the standard form and relational qualities of the franchise contract contribute to imbalance of power and to uncertainty for a franchisee for the following reasons:
 - the drafter/franchisor has power, while the other party, a franchisee, must rely on trust, reputation and other factors outside the contract;
 - a franchisor can manage risk through contract, but a franchisee cannot; and
 - the relationship can only take shape over time according to the specific dictates of the drafting party.
- A franchisee takes on qualities of consumer of product, rather than an equal party to negotiation of terms.
- These problems are compounded by the fact that statutory regulation focuses on contract formation with the result that the relational qualities lose meaning.
- Court interpretation of the contract lacks the contextual element because contextual interpretation is trumped by formal rules and express contract terms that a franchisee often does not understand because it did not draft or negotiate the contract.

Chapter Five

Contract Terms Analysis

“Standard franchise agreement” means the standard terms and conditions pertaining to the grant of a franchise by us as amended by us from time to time in our absolute discretion.’⁴⁶⁹

5.0 INTRODUCTION

This chapter provides an analysis of contract terms as follows:

First, by assessing whether these contract terms reflect imbalance of power and uncertainty in the relationship this chapter tests Chapter Four’s theoretical analysis of contract as a private layer of governance that reinforces these conditions. It provides an analysis of ten contract terms from nineteen contracts sampled. The purpose of each contract term is explained and the interests of both a franchisor and a franchisee are outlined with respect to each term. Each section includes a table containing the different formulations of the term from across the sample, unless the length requires that they be provided in an appendix. Secondly, this chapter will also explore how contract terms confer higher levels of discretion upon a franchisor than upon a franchisee. Thirdly, there is a description of direct intervention in each contract term, including the applicable Code provisions with respect to each contract term. (A discussion of regulation will then be taken up in greater detail in Chapters Six and Seven.) Fourth, each section in this chapter also discusses case law that has dealt with the subject matter of that contract term. Finally, each section includes a summary of the findings with respect to each term.

⁴⁶⁹ System F5.

5.1 CONTRACT TERMS ANALYSIS

Contractual terms are sampled to measure the extent to which regulation is achieving its goals; through the content analysis it is possible to assess whether the regulation is ‘effective’, in the sense of ‘successful in producing a desired or intended result,’ the result being the stated goals of regulation of franchising in Australia. Table 5.1 lists the stated goals of regulation in the first column. Contract is not amenable for use as a tool to measure all the stated objectives of regulation; the second column identifies goals that may be measurable through an analysis of the terms of the contract.

Table 5.1: Stated Goals of the Regulation of Franchising

Regulatory Objective	Contractual Result
1) Raise standards of conduct in the franchising sector without endangering the vitality and growth of franchising	No direct and measurable contractual result
2) Reduce risk and generate growth in the sector by increasing the level of certainty for all participants/ Provide an environment of certainty	Contract terms will reflect certainty
3) Address the imbalance of power between franchisors and franchisees	Contract terms will reflect a balance of power
4) Ensure minimum standards of disclosure	No direct and measurable contractual result
5) Ensure the sector has strong role in the development and maintenance of its regulatory environment	No direct and measurable contractual result
6) Ensure suitable remedies and sanctions for breach of the Code	No direct and measurable contractual result
7) Reducing the incidence of disputes and litigation in the sector / Reduce the cost of resolving disputes in the sector	No direct and measurable contractual result
8) Reduce unfair commercial conduct by franchisors /Bring about cultural change that results in higher standards of commercial behaviour ⁴⁷⁰	No direct and measurable contractual result, but attainment of this goal may be indicated by levels of certainty and balance of power

As the table illustrates, some objectives do not lend themselves to evaluation using the contract. For example, contract cannot be used as an indicator of compliance with

⁴⁷⁰ Explanatory Statement - *Trade Practices (Industry Codes - Franchising) Regulations 1998* (Cth) No. 162

<<http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrument1.nsf/framelodgmentattachments/77630AD9222B25BCCA256F73000E7654>> at 9 December 2006.

disclosure requirements. In some cases contract may signal parties' intentions to conform to disclosure requirements. In other cases the Code requires disclosure of contract terms. About eighteen of twenty-one disclosure items are or relate to contract terms, but only about half of the terms typically found in the contract are subject to disclosure. It is not possible to discern from most contract terms whether there is compliance with disclosure requirements, because disclosure is a separate document, which was not supplied for the sample. However, for most of the contract terms in the sample, disclosure requires disclosure of 'conditions of the franchise agreement that deal with' the particular issue. So, for most terms, it is possible to infer from the content of the contract that there is likely compliance with disclosure requirements.

The analysis also omits consideration of 'minimum standards' (as in goal four) and 'higher standards' (as in goal eight) as neither is defined in the regulation or regulatory impact statement. It may be reasonable to infer, however, that they are met to some extent by the attainment of the goals of regulation that are measurable with respect to certainty and balance of power (see below).

The two stated objectives that are measured in this content analysis are goals two and three; they appear in bold in the table. The hypothesis is that, if the current regulatory regime is meeting its stated goals, the contract will reflect 1) a balance of power and 2) certainty for both parties. With respect to the first goal, contract can be used to evaluate the balance of power in the relationship by measuring rights and obligations of each party to the contract. Balance of power in the contract is indicated by a contract that reflects the interests of both parties, the balance of rights and obligations, the reciprocity of obligation, and the reciprocity of flexibility and discretion. Other factors that affect balance of power will be considered such as proportionality; availability of meaningful alternatives and relative fall-back positions; need for an agreement; unity as opposed to division; financial reserves; and reputation for toughness as opposed to reputation for being willing to compromise; necessity; the nature of the good or service; ability to negotiate terms; wealth; business sophistication; education or knowledge; race; gender; "size" of the parties; monopoly power; and consumer status.⁴⁷¹

⁴⁷¹ See definitions section for quotations relating to these qualities of bargaining power discussed in John Black, *A Dictionary of Economics* (2002) accessed via *Oxford Reference Online*,

With respect to the second goal, contract can be used also to measure certainty. This is done by measuring specificity; contractual terms that are specific provide greater certainty than contractual terms characterized by high levels of flexibility and discretion. Uncertainty refers in this dissertation to the inability of a franchisee to predict, and so it is closely related to flexibility in the contract, grants of discretion to a franchisor, and risk to a franchisee. A party to a contract may gain a measure of certainty by controlling dispute resolution procedures and being granted discretion. Either party can do this by ensuring its ability to fill the gaps, by ensuring it has the power to decide matters left unspecified in the contract. The analysis measures the reciprocity of that discretion. A low level of reciprocal discretion in the contract indicates more certainty for the party that enjoys higher discretion, less for the party conferring the discretion. If the current regulatory regime for franchising in Australia is meeting its stated goals, the flexibility in contract terms will reflect both parties' intentions. Gaps in the contract will be understood and their implications agreed to by both parties. This information in turn will be available to courts in interpreting franchise contracts.

In the following sections eight contract terms are individually evaluated for the extent to which they reflect the two stated goals of regulation of the sector. Each term is evaluated with respect to whether it reflects 1) a balance of power between the parties; and 2) certainty. As the Table 5.2 below shows, balance of power will be measured through balance of rights and obligations, balanced flexibility and discretion and other safeguards or measures, if any. Certainty will be measured by specificity versus flexibility and discretion in the contract terms and by reciprocal discretion in contractual terms.

<<http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t19.e185> at 20 November 2006; and Daniel D. Barnhizer, 'Inequality of Bargaining Power' (2005) 76 *University of Colorado Law Review* 139, 199-201.

Table 5.2: Criteria Used to Test Hypotheses

Hypothesis	Criteria
If the current regulatory regime is meeting its stated goals, contract terms will reflect a balance of power.	Measure balance of power in the contract as indicated by <ul style="list-style-type: none">- balance of rights and obligations- balanced flexibility and discretion- other safeguards or measures, if any
If the current regulatory regime is meeting its stated goals, contract terms will reflect certainty	Measure certainty in the contract: <ul style="list-style-type: none">- specificity versus flexibility and discretion

5.2 CONTRACT TERMS EVALUATED IN THIS ANALYSIS

The following contract terms are covered in detail in this chapter, offering a representative view of different stages of the relationship:⁴⁷²

- Terms relating to the roles of the parties and the scope and duration of the agreement:
 - Scope of grant
 - Term and right of renewal
- Terms relating to performance:
 - Franchisor obligations regarding advertising
 - Supply to franchisee
 - Franchisee minimum performance and reporting requirements
- Terms relating to exit:
 - Transfer
 - Termination
- Terms relating to adjustments to the contract and contractual restraints:
 - Restraint of trade
 - Adjustments to the contract/Collective agreement

Two other terms are discussed in this Chapter, but in less detail. The ‘independence of franchisee’ clause was introduced in Chapter Three and is included in some of the

⁴⁷² Two terms from the original sample (i.e. lease and ownership of intellectual property and goodwill) have been omitted from this discussion because of the length and complexity a discussion of these terms would require and because neither term is governed primarily by the Code. Franchisee Independence is one other term of the agreement discussed in Chapter Three and partly incorporated into the analysis in this chapter.

discussion in this chapter. This chapter also includes a discussion of the ‘collective agreement’ clause, a term that appears in some, but not most, contracts sampled.⁴⁷³

⁴⁷³ A complete sample franchise agreement can be found in *Franchising Law and Practice*, <<http://www.lexisnexis.com.ezproxy.bond.edu.au/au/legal/results/pubTreeViewDoc.do?nodeId=TAAKAAF&pubTreeWidth=23%25> at 2 March 2007.

5.3 CONTRACT TERM: SCOPE OF GRANT

A franchise is a licence to operate the franchise unit at a specified location or geographic area, and to use the intellectual property, operations manual, and images to the extent permitted by the scope of the grant. The Scope of Grant clause defines the scope of the licence a franchisor grants to a franchisee to use intellectual property rights and sets the limits on that use.⁴⁷⁴ Details of the grant may be found also in ancillary documents that licence specific rights to use intellectual property such as trademark.

This term, like all franchise contract terms, reflects the balance of competing interests struck by the parties. A franchisee wants to maximize the extent of the rights it is buying from a franchisor. A franchisee prefers an exclusive right to use the intellectual property as extensively possible in order to ensure 1) that it will benefit from his own efforts to develop his business at a particular location and 2) that its investment is secure from franchisor encroachment, the trespassing on the rights of a franchisee by a franchisor. A franchisor, on the other hand, wants to protect its flexibility and its options to expand and develop the system and brand awareness, to limit what it grants to a franchisee and retain, as far as possible, its own rights to use and sell the rights to the intellectual property to others.

Encroachment, the act of entering 'gradually or stealthily into the possessions or rights of another',⁴⁷⁵ is a common concern for franchisees. Encroachment by a franchisor can take a variety of forms, such as franchisor development of alternative distribution channels through supermarkets; kiosks; convenience stores; independent retailers; and non-traditional or seasonal locations, including universities, workplaces, and special events. A franchisor may initiate a mail order operation or provide services from outside a franchisee's area into his market through the use of the Internet (known as 'virtual encroachment'). Increasingly, encroachment occurs when a franchisor acquires a competing brand and shares information with franchisees from

⁴⁷⁴ For a general overview of grants clauses in intellectual property see Donald M. Cameron, *The Grant Clause* (1997) JurisDiction <<http://www.jurisdiction.com/grant.htm>> at 15 March 2006.

⁴⁷⁵ *Merriam-Webster's Dictionary of Law*, Dictionary.com <<http://dictionary.reference.com/browse/encroach>> at 29 Jul. 2007.

the other brand.⁴⁷⁶ A 2003 survey carried out in the US showed that 24 percent franchisees had been "threatened, encroached upon or coerced into unwanted expansion by their franchisor."⁴⁷⁷

Perhaps the most common form of encroachment involves a franchisor placing a competing unit close to an existing unit. Franchisors are 'obsessed' with selling franchise units⁴⁷⁸ because initial entry fees are a critical source of franchisor income, and because each new unit adds to brand awareness, which in principle enhances the value of the franchise system. Franchisees, however, do not share a franchisor's enthusiasm for opening new stores. The following hypothetical illustrates the conflict of interest between franchisor and franchisee:

A franchisee operates a unit that grosses \$10,000/week. A franchisor decides to open another store two or three hundred metres away. Within a few months the new unit grosses \$7,000/week, but perhaps \$3000 of that is pulling from the first store's business. For a franchisor, two stores each making \$7000/week is preferable because a franchisor receives royalties on \$14,000 rather than \$10,000. But to the extent that the second unit does pull \$3000 in business from the first, unless sales increases outpace the losses to encroachment, franchisees' profit margins decline.⁴⁷⁹ The first franchisee loses business, and the second franchisee may never be as profitable as it might have been if the area development had been more carefully planned.

⁴⁷⁶ Co-branding involves a franchisor owning multiple franchise systems and brands, or franchisors agreeing to market together. Co-branding increases royalty revenue for the franchisor, but, like other forms of encroachment, can dilute the value of the brand to the franchisee. *Concise Legal Dictionary*, (3rd ed, 2004).

⁴⁷⁷ Tina Perazzini of Subway stated her employer's policy on encroachment during the 1990s: "We put them up any f***ing place we could.", Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 185.

⁴⁷⁸ Lorelle Frazer, Professor of Marketing, Griffith University, 'Are Franchisees Potential Competitors? A Study of Franchisees Who Exit the System but Continue Operating', (Paper presented at the 18th International Society of Franchising Conference, Las Vegas, 2004), <http://www.huizenga.nova.edu/business/abstracts/abstracts2004/Paper%2014_2004_Frazer_Abstract.doc> at 30 December 2005.

⁴⁷⁹ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 310. This is particularly of concern to franchisees in low margin industries such as quick-serve restaurants.

A franchisor can be expected to draft this contract term to protect its right to encroach and limit a franchisee’s exclusive rights. Table 5.3 below provides the results of the sample.

Table 5.3: Summary of Scope of Grant Terms in Contracts under Review

Franchise System ⁴⁸⁰	Scope of Grant
F1	Non-exclusive (franchisor can construct, operate and sell anywhere in franchisee’s territory except Premises)
F2	Non-exclusive licence to use the Franchise System only in the Business; ...rights granted to the Franchisee are exclusive only for the Premises located within the Territory.
F3	Exclusive licence at the location... does not affect franchisor’s right to appoint other franchisees with rights to sell the products except with respect to territory or to sell within territory as long as not thru a trademark restaurant
F4	Non-exclusive, subject to Clause 9, does not affect franchisor’s right to sell to any person at any location or appoint other franchisees with rights to sell the products
F5	Franchisee has the exclusive right to operate the franchise in the territory
F6	Not an exclusive franchise territory
F7	Non-exclusive licence as a franchisee to establish and operate using the Marks, Image, System and other Intellectual Property on the terms and conditions set out in this Agreement.... The Franchise granted pursuant to this Agreement is not an exclusive franchise and the Franchisor may grant other Franchises
F8	The Licence hereby granted is not an exclusive Licence and the Licencee acknowledges that the Licensor may grant licences to other licencees to: (a) establish an operation in other locations; (b) use the Marks and Intellectual Property within the Territory
F9	The Franchisee shall use the rights solely and exclusively in connection with the Business and the Franchisee specifically acknowledges and agrees that it will not pursue in any manner any sales whatsoever in respect of the Business other than in, at or from the Premises, and it will not pursue any wholesale sales anywhere without the Franchisor's written consent and if such consent is given, any wholesale sales shall be carried out and Products produced therefore only from the Premises. The Franchisee agrees that it shall conduct its Business only from the Premises and at no other place. The Franchisee shall conduct the Business in accordance with all rules, regulations and procedures prescribed or promulgated by the Franchisor from time to time....The Franchisor agrees that during the term of this

⁴⁸⁰ Industry codes for each system are as follows: System F1- 11, System F2- 11, System F3- 11, System F4- 11, System F5- 12, System F6- 11, System F7- 11, System F8- 10, System F9- 11, System F10- 10, System F11- 10, System F12- 9, System F13- 12, System F14- 11, System F15- 12, System F16- 9, System F17- 11, System F18- 10, System F19- 7.

	agreement it will not grant to any other person the right to use the Franchisor System within 500 metres of the Premises without the prior consent of the Franchisee.
F10	Complex structure for service franchise (lawn mowing and garden services) Non-exclusive, flexible
F10*	As in F10 above
F11	Non- Exclusivity – The parties acknowledge: <p style="margin-left: 40px;">(a) Franchisor may grant other Franchisees to other persons to establish and operate businesses similar to the Business anywhere in the world;</p> <p style="margin-left: 40px;">(b) the (franchisee) is restricted to carrying on the business in Australia</p>
F12	Subject to the Franchisee’s strict compliance with the terms of this agreement, the Franchisor grants to the Franchisee a licence to use the Systems and the Intellectual Property in the operation of the Business for the Term.
F13	...the right to establish and operate a business at the location ... (“the location”).
F14	<p>The licence ... does not grant you possession of the Business Premises to our exclusion nor does it give you any property rights in or over the Business Premises.</p> <p>We may retain keys to the Business Premises and have unlimited access to the premises for the purposes of this Agreement or the Manual.</p> <p>You do not have any right to seek an order for possession of the Business Premises or commence proceedings for trespass or nuisance - such rights rest solely with us.</p> <p>... We will not, during the term of this Agreement open another store or grant a franchise to operate a store within the Territory.</p> <p>The licence hereby granted is personal to you. You must not assign, transfer, subcontract or otherwise dispose of, in whole or in part, your rights and obligations under this Agreement to any person or part with possession of the Business Premises without our prior written consent</p>
F15	...not an exclusive franchise territory. The Franchisor grants to the Franchisee the Franchisee Right of First Refusal, (which may only be exercised in writing if the Franchisee is in full compliance with this Agreement), over any franchise it proposes to offer in respect of the establishment of a Shop at a site which is within the distance of the Premises specified as the First Right of Refusal Zone at better than or at least on the same terms as the proposed franchise offer.
F16	<p>Except as permitted by this Agreement, the Franchisor must not during the term, itself operate or licence another to operate the Business within the Master Franchise area or itself operate or licence others to operate Franchises.</p> <p>Without limiting its rights elsewhere under this Agreement, if the Master Franchisee does not meet his obligations under Part 5, the Franchisor may at</p>

	<p>any time thereafter:</p> <p>(a) by itself or by licensing or by a joint venture with other persons, operate within the Master Franchise Area a number of Franchises not exceeding the different between the number of Franchises which must be developed and in operation for that year of the Term and the number of Franchises actually commissioned by the Master Franchisee during that year; or</p> <p>(b) reduce the size of the Master Franchise Area and licence another to operate a Franchisor Master Franchise within the former Master Franchise Area in respect of which the Master Franchisee no longer retains exclusivity.</p> <p>Franchisee acknowledges that the Franchisor may, outside or within the Master Franchise Area, develop and establish other systems, using the name and proprietary marks which are similar to the marks, or any other proprietary marks, and grant licences or franchises therefore without providing any rights therein to the Master Franchisee or Sub-Franchisees.</p>
F17	<p>Subject to this agreement we give you, and you accept a non-exclusive franchise during the franchise term at and from the store, to:</p> <ul style="list-style-type: none"> - use the system to develop the store and to run your business; - use the trade marks in connection with your business; and - use the Franchisor food and beverage menus to supply the approved foods and beverages. <p>Protected franchised area</p> <p>Subject to you complying with the transaction documents. during the franchise term we will not in the protected franchised area give anyone else other than you the right to set up or run a (unit) without your prior written consent so long as the protected franchised area is not to apply in respect of any store that already exists or is under development at the date of this agreement in the protected franchised area. Nothing in this agreement prevents any existing operator of a store in the protected franchised area from redeveloping or expanding its existing business or relocating its business to new premises within the area. However, the right to a protected franchised area will end if at any time during the franchise term you make default under this agreement and do not remedy the default within 30 days of getting written notice from us to do so.</p> <p>Right of first refusal area</p> <p>Subject to you complying with the transaction documents during the franchise term, we give you a right of first refusal in respect of the grant of a Franchisor franchise for one extra Franchisor store within the right of first refusal area on the basis that the Franchisor franchise will be granted on the then current franchise agreement and transaction documents applicable to the type of Franchisor store that is proposed to be opened and will involve a payment by you to us of the then current initial franchise fee and other fees that are then customarily and ordinarily payable to us or our associates for the grant of a Franchisor franchise.</p>

	<p>- the rights under your franchise cannot be used by you or your associates at another site or in another area except under another franchise agreement or other agreement with us; and we, our associates or anyone else may in Australia and elsewhere in the world develop, open or run other Franchisor stores and/or allow others to develop, open or run other Franchisor stores except as stated in clauses 3.2 and 3.3.</p> <p>During your franchise, we will give you a right (sublicence) to use the Franchisor trade name or mark in connection with the store and your business.</p>
F18	<p>The Franchise shall be subject to the following qualifications and restrictions</p> <p>...</p> <p>Franchisor reserves the right to appoint new Franchise Owners, agents or representatives without restriction</p>
F19	<p>In consideration of the performance by the Member of its obligations under this agreement, the Company grants to the Member a non-exclusive right to use the Intellectual Property in the course of carrying on the Business at the Location during the Term on the terms and conditions of this agreement....</p> <p>During the Term, the Company agrees not to grant any other person the right to use the Retail Brand as the brand of a pharmacy in the Territory, without prior written approval of the Member.</p>

Note: * F10 appears twice, first as the existing contract and second as a revised contract of the same system with significant proposed revisions.

Discussion of results

Over half of the contracts in the sample explicitly state that the grant to a franchisee is non-exclusive. Franchisors may refuse to make grants to franchisees of exclusive territory, citing the need for flexibility in responding to market conditions. Where franchisors do grant exclusive territories to franchisees, the contract provision often covers only the unit premises. The franchise contracts in the sample indicate that the prevailing practice is to limit the licence to a franchisee's premises, but even this right may be subject to franchisor oversight; one contract provides that the franchisee has no property rights over premises; the franchisor keeps keys, and has unlimited access to the premises.⁴⁸¹ Several contracts in the sample (Systems F1, F2, F4, and F5) granted an exclusive licence to the use the intellectual property, limited to the defined territory or the shop premises.

⁴⁸¹ System F14.

Most of the contracts sampled provide very limited, if any, restraints on a franchisor's use or further grant of the intellectual property beyond a franchisee's premises. Some expressly ensure a franchisor's discretion. Franchise contracts that contain language reserving a franchisor's rights provide a substantial legal basis to uphold a franchisor's right to encroach (Systems F1, F2, F4, F7, and F8). One contract sampled specifically protects a franchisor's right to do business on the Internet.⁴⁸²

The grant of an 'exclusive' right at the premises or similar language may give the illusion of greater protection of its rights than a franchisee actually enjoys. A franchisee with an 'exclusive' licence may not in reality gain real assurance against franchisor encroachment. Some contracts, however, do include limits on a franchisor's licensing of the intellectual property in the franchisee's territory,⁴⁸³ and one of the contracts in the sample imposes a duty on a franchisor to protect a franchisee's territory.⁴⁸⁴

Three of the contracts contained a franchisee right of first refusal, so that if a franchisor wishes to open a new unit near a franchisee, the franchisee has the first option to take that unit.⁴⁸⁵ In some cases a right of first refusal is a benefit to franchisee but it can be double-edged sword; it can create added risk for the franchisee, while giving the appearance of offering franchisee protection.

Keeping a franchisor's options open is a justifiable discretion to the extent that it benefits the system and all franchisees; it may be less justifiable where it adversely affects the rights of an individual franchisee to conduct its business. To the extent that a franchisor retains the right to use and sell the intellectual property, notwithstanding any rights sold to a particular franchisee, then that franchisee is receiving correspondingly less value for its investment in the right.

If, as in the sample, the guarantee of exclusivity is absent, or is limited to a franchisee's premises, a franchisor is free to open a new unit a block or two away and a franchisee has no right to stop it. This creates uncertainty for a franchisee. Without contractual protection, a franchisee that is faced with franchisor encroachment is

⁴⁸² System F7.

⁴⁸³ System F16.

⁴⁸⁴ System F2.

⁴⁸⁵ Systems F6, F15, F17.

forced to rely on a vague standard such as the principle of unconscionable conduct, though its application in franchising cases generally has been unhelpful to franchisees.⁴⁸⁶ A franchisee might have some faint hope of prevailing on a claim of lack of good faith by a franchisor in the exercise of its discretion.

The sample indicates that this contract term reinforces a franchisor's interest in maximum discretion and flexibility to exploit the intellectual property freely outside a franchisee's premises and so it reflects an imbalance of power between the parties and uncertainty for a franchisee.

Case law relating to scope of grant and encroachment

In *Neilson Investments (Qld) P/L and Ors v Spud Mulligan's P/L and Ors*,⁴⁸⁷ a franchisee, the plaintiff, purchased a franchise that failed. Meanwhile, the defendant, the franchisor, had built a competing store within three kilometres of the franchisee's store. The franchisee claimed to have relied on representations by franchisor that had induced him into entering franchise agreement. The court held for the franchisee; the franchisor was found to have breached the Trade Practices Act (the TPA) sections 52 and 82.

In *Bamco Villa Pty Ltd v Montedeen Pty Ltd*,⁴⁸⁸ a franchisor set up its own outlet 200 meters from the boundary of a franchisee's exclusive territory and directed Telstra to divert calls to the franchisee's business to the franchisor. This damaged the franchisee's business and it was forced to sell the premises. The sale constituted grounds for termination, and the franchisor terminated the franchise agreement. The franchisee alleged breach of an implied term of good faith; breach of an express term 'to use best endeavours to promote the mutual business interests of the parties'; and unconscionable conduct under section 51AC of the TPA. The court held that the franchisee's breach 'was not a breach which the franchisor, acting in good faith and reasonably, ought to have relied upon as a ground for exercising the power to terminate the franchise agreement.' The franchisor was in breach of the express term, and its conduct was held to be unconscionable in breach of section 51AC of the

⁴⁸⁶ Jenny Buchan, 'Who is the franchisee contracting with and does it matter anyway?' (Paper presented at the 51st ICSB World Conference, 2006, Melbourne, Australia). There are few cases in franchising where a court has held in favour of a franchisee on a claim of unconscionable conduct.

⁴⁸⁷ *Neilson Investments (Qld) P/L and Ors v Spud Mulligan's P/L and Ors* [2002] QSC 258.

⁴⁸⁸ *Bamco Villa Pty Ltd v Montedeen Pty Ltd* [2001] VSC 192.

TPA. No contract in the sample contains a term similar to the express term that was found to have been breached by the franchisor in the case.

In *Far Horizons Pty Ltd v McDonald's Australia Ltd*,⁴⁸⁹ McDonald's decided to open a new restaurant near an existing franchisee, but did not offer the franchise to this franchisee. The franchisee had no territorial rights nor any express contractual right to be offered this franchise, but it alleged that McDonald's forced it out of the system and breached the implied duty of good faith. Though on the facts there was insufficient evidence to prove McDonald's lack of good faith, the case is significant because the court held that there was an implied duty of good faith,

'there is to be implied into a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose'.⁴⁹⁰

With respect to virtual encroachment, in *Dymock's Holdings Pty Ltd v Top Ryde Booksellers Pty Ltd* the court held that the franchisor's website was in direct competition to the franchisees.⁴⁹¹

While these cases show that a franchisee can prevail in some cases of franchisor encroachment, there is no contractual term that a franchisee can rely upon. Instead, a franchisee must hope that a court will sympathize with one of its claims that might include, variously, breach of section 52, or section 51 AC of the TPA or a duty of good faith.

Direct intervention in scope of grant

In the US franchisee interests continue to lobby for increased regulation to protect franchisees against franchisor encroachment.⁴⁹² In Australia the scope of grant provision is regulated only through disclosure requirements.⁴⁹³ The Franchising Code

⁴⁸⁹ *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310.

⁴⁹⁰ Extraneous purpose includes trying to force a franchisee out.

⁴⁹¹ *Dymocks Holdings Pty Ltd v Top Ryde Booksellers Pty Ltd & Ors* [2000] NSWSC 795. Franchisors note that the case illustrated the challenge for franchisors in integrating an e-business strategy within their franchise systems. For related articles see <<http://www.lawgazette.com.sg/2001-7/July01-feature2.htm>> at 22 July 2005.

⁴⁹² Chris van Assche, Deacons Consulting, *Lessons From Uncle Sam: US Trends in Franchising* (2002) <<http://www.deaconsconsulting.com/mediacentre/articles/shouldifran.pdf>> at 30 December 2005.

⁴⁹³ A grant of exclusivity may cause anti-trust law problems in some jurisdictions. In the European Community, for example, it is possible to grant exclusivity only with an individual exemption under article 81(3) of the Treaty of Rome or within the de minimis exemption. Even then it must comply with

of Conduct Disclosure Item 8 requires disclosure of five items of information, whether or not the information is in the contract:

Disclosure Item 8

- whether the franchise is for an exclusive or non-exclusive territory or limited to a particular site;
- whether the franchisor or its associates may operate a business that is substantially the same as the franchise in the franchised territory;
- whether the franchisor or its associates may establish other franchises that are substantially the same as the franchise in the franchised territory;
- whether you may operate a business that is substantially the same as your franchise outside the franchised territory; and
- whether the franchisor may change the territory.

Disclosure under the Code provides no more information to a franchisee than the contract itself as to the nature of the conditions that will be required.

Measures to address imbalance of power and lack of certainty in scope of grant

Because the greater power resides with a franchisor and because there is a high level of uncertainty for franchisee with respect to risk of franchisor encroachment, which can occur in a variety of ways, disclosure cannot be relied upon to avoid the problems encroachment can cause.⁴⁹⁴

One possible method to enhance certainty is clearer specification of location specifications, criteria, and conditions connected to the grant and franchisee's rights. Another measure is to ensure greater reciprocal commitment; this could help with balance of power. For example, the restraint of trade limitations imposed upon a franchisee are not balanced by protection of a franchisee against franchisor encroachment on a franchisee's operation. Greater sharing of benefits could also increase the alignment of franchisor and franchisee interests. There could be, for example, compensation for franchisees affected by encroachment.⁴⁹⁵ A franchisor who benefits from additional locations might consider sharing in the existing

the laws of the member state. Competition law implications in Australia are covered under the restrictive trade practices provisions of the TPA.

⁴⁹⁴ In the US horizontal allocations of territory are per se illegal, but vertical allocations are analysed according to the rule of reason. Most franchisors justify territorial allocations for purposes of interbrand competition. See M. J. Morris, and D. D. Smith, *Government Regulation of Franchises* (1991) Franchise Smith <<http://franchisesmith.com/chap67.htm>> at 30 December 2005.

⁴⁹⁵ Chris van Assche, Deacons Consulting, *Lessons From Uncle Sam: US Trends in Franchising* (2002) <<http://www.deaconsconsulting.com/mediacentre/articles/shouldifran.pdf>> at 30 December 2005.

franchisee's decrease of profits by making a financial contribution, reducing the royalty rates or requiring the new franchisee to pay a portion of its royalties to the affected franchisee.⁴⁹⁶ In some cases there might be a formula to compensate franchisees negatively affected by encroachment.⁴⁹⁷ Finally, a franchisee nearest the new unit should consider negotiating the terms of a right of first refusal to a new unit.⁴⁹⁸

Other methods are procedural. Both certainty and balance of power can be addressed by proper procedures for matching franchisees with appropriate franchise units and territories. For example, a franchisor should ensure that a franchisee is properly selected, that the size of the territory is carefully determined. A franchisee's skills and resources can inform a determination of the geographical scope of the territory. Franchisee cooperation can also help to formulate appropriate terms to allow franchisor return and franchisee return on investment. These procedures should include provisions for franchisee involvement and input. There should also be a process through which a franchisor can make changes to territory allocations.

Another procedural measure could be the use of business and development plans. These can help consensus-building and create certainty so cooperative involvement in business and development plans is recommended. Incorporation of any business plan into the development schedule will help to encourage a realistic approach by a franchisee and enable a franchisor to allocate its resources more effectively. The business plan should reflect any anticipated weaknesses as well as strengths to increase certainty for the parties. Such plans can also include specification of what franchisee rights are protected, along with a description of the process by which a franchisor can establish new franchised or company-owned units, make changes to territory allocations, and/or undertake its own marketing efforts on the Internet. Only one contract in the sample required a business plan, not for the system, but for the franchised unit. None of the contracts in the sample included a development plan

⁴⁹⁶ Robert Zarco on behalf of franchisees, in Michael H. Seid, David Kaufman, and Robert Zarco, *Franchise Encroachment, Part 1: Most Significant Encroachment Issues* (2000) Entrepreneur.com <<http://www.entrepreneur.com/article/0,4621,283208-2,00.html>> at 4 January 2006.

⁴⁹⁷ Chris van Assche, Deacons Consulting, *Lessons From Uncle Sam: US Trends in Franchising* (2002) <<http://www.deaconsconsulting.com/mediacentre/articles/shouldifran.pdf>> at 30 December 2005.

⁴⁹⁸ David Kaufman, and Robert Zarco, *Franchise Encroachment, Part 1: Most Significant Encroachment Issues* (2000) Entrepreneur.com <<http://www.entrepreneur.com/article/0,4621,283208-2,00.html>> at 4 January 2006.

(franchisors may want to consider also section 51AC which requires parties to disclose future plans).⁴⁹⁹

Some of the foregoing procedural measures are best handled cooperatively. Cooperative and collective action can help franchisees to gain a level of understanding and certainty, rather than be subject to interpretations of franchisor good faith. Cooperative involvement in business and development plans, proper procedures for matching franchisees with appropriate franchise units and territories, and cooperation in formulating appropriate terms to allow franchisor return and franchisee return on investment all can help redress imbalance of power and uncertainty. The alternative is that these conditions will be reinforced when franchisees are excluded from important business functions and processes.

⁴⁹⁹ The contracts in the sample were predominantly established franchise systems. Development plans might be more common in new, developing systems and/or with in systems entering new markets. It is also probable that such plans do not appear in the contract boilerplate. While this study can determine what provisions appear in contracts, this is not to say that because a practice is not provided for in the contract, it therefore is not part of a given system. Including it in the contract, however, is a step toward ensuring that the practice will be followed.

5.4 CONTRACT TERM: DURATION AND RIGHT OF RENEWAL

The duration of the contract and right of renewal, if one is provided for, are commonly included together in the early sections of the franchise contract. The length of the contract, any ensuing renewal period, and the conditions placed upon it, are important considerations for both franchisor and franchisee, but once again their interests conflict. A franchisee prefers an initial contract duration long enough to allow it to recoup its investment and to achieve a reasonable return on its original capital investment.⁵⁰⁰ Franchisee fees allow a franchisor to recover the costs of its investment in the development of the unit.⁵⁰¹ A franchisor typically prefers relatively short contract duration with a conditional option to renew.⁵⁰² Shorter contract duration gives a franchisor the opportunity to collect further fees at transfer or renewal or upon sale of the franchise to a new franchisee. The conditions of renewal give franchisors the opportunity to impose additional operating requirements, to require franchisees to upgrade premises and/or to undertake additional obligations.⁵⁰³

Established systems, larger territories, and master franchise arrangements often involve longer contract durations, probably because of larger investments by franchisees and longer time frames required for franchisees to achieve reasonable returns. Another reason for longer terms is that more experienced franchisor systems and franchisee operators are involved. It is common that McDonald's contracts run for twenty years and typically do not offer a right of renewal. Longer duration contracts are less likely to carry with them automatic rights of renewal due to higher risk exposure if franchisees do not perform, or relations break down. Because the initial contract duration for a McDonald's franchise is around twenty years, there is ample opportunity for a franchisee to recoup his considerable initial investment. It is therefore reasonable to expect that a franchisor will be unwilling to commit to right of renewal at the end of the twenty year contract duration. This is a good example of the

⁵⁰⁰ Jeff Elgin, *Ready to Commit? About to buy a franchise but intimidated by the licence agreement? We explain what to look for before you sign on the dotted line* (2005) Entrepreneur.com <<http://www.entrepreneur.com/article/0,4621,321573,00.html>> at 10 August 2005.

⁵⁰¹ The share parameter or royalty, on the other hand, is set so as to compensate the franchisee and the franchisor for the costs of their ongoing efforts.

⁵⁰² Jeff Elgin, *Ready to Commit? About to buy a franchise but intimidated by the licence agreement? We explain what to look for before you sign on the dotted line* (2005) Entrepreneur.com <<http://www.entrepreneur.com/article/0,4621,321573,00.html>> at 10 August 2005.

⁵⁰³ Ibid.

need for different approaches depending upon the stage of maturity and development of the franchise system.

Franchisors are perennially concerned with the pool of qualified potential franchisees. Currently much of what a franchisor does is geared to make a franchisee as ‘substitutable’ as possible.⁵⁰⁴ Franchisees are often surprised to find that their share at transfer or termination does not meet expectations.⁵⁰⁵ A franchisee wants a term long enough to recoup its investment, to have something to sell upon exiting the arrangement, and not to be subject to franchisor hold-up. The term ‘right of renewal’ is a misnomer to the extent that the term does not spell out a right of a franchisee as much as it outlines conditions and ensures franchisor discretion not to grant renewal.

Table 5.4: Summary of Contract Duration and Right of Renewal Terms in Contracts under Review

Franchise System	Contract duration, right of renewal
F1	5/5 year term and right of renewal. Right to renew subject to conditions
F2	10/10 year term and right of renewal. Right to renew subject to conditions. (a)(ii) franchisee not pay new Franchise Fee (but \$5k renewal fee per schedule)
F3	Term not specified in the contract. First Renewal At the end of the Initial Term, the Franchisee may renew the Franchise for the Renewal Term if: the Franchisee notifies the Franchisor of the election to renew (the Renewal Notice) at least six months before the end of the Initial Term; the Franchisee is not in breach of any provision of this agreement when the Renewal Notice is given or at the end of the Initial Term; the Franchisee pays to the Franchisor on demand the Franchisor's reasonable costs (including legal costs on a solicitor and own client basis) of and incidental to the renewal of the Franchise; the Franchisee and each Principal executes and delivers to the Franchisor a then current Franchisor Business franchise agreement (which may differ from this agreement as to material and non-material terms and conditions); the Franchisee remodels, repairs and redecorates the Location to ensure that they conform to the Image; and the Franchisee and each Principal comply with such other conditions as the Franchisor may reasonably impose.

⁵⁰⁴ The author is not aware of any economic analysis that has been conducted on the economic benefit to franchisor of franchisee longevity compared to high franchisee turnover.

⁵⁰⁵ Telephone interview with Richard Evans, Franchising Council of Australia, late 2004.

	<p>Second Renewal</p> <p>At the end of the first Renewal Term, the Franchisee may renew the Franchise for a second Renewal Term if:</p> <p>the Franchisee notifies the Franchisor of the election to renew (the Renewal Notice) at least six months before the end of the first Renewal Term;</p> <p>the Franchisee is not in breach of any provision of this agreement when the Renewal Notice is given or at the end of the first Renewal Term;</p> <p>the Franchisee pays to the Franchisor on demand the Franchisor's reasonable costs (including legal costs on a solicitor and own client basis) of and incidental to the renewal of the Franchise;</p> <p>the Franchisee and each Principal executes and delivers to the Franchisor a then current Franchisor Business franchise agreement (which may differ from this agreement as to material and non-material terms and conditions);</p> <p>the Franchisee remodels, repairs and redecorates the Location to ensure that they conform to the Image; and the Franchisee and each Principal comply with such other conditions as the Franchisor, acting reasonably, may impose.</p>
F4	5/5 year term and right of renewal; Franchisee must pay renewal fee... will not be required to pay any further Initial Franchise Fee
F5	Term not specified in the contract s20 You must pay to us the territory renewal fee in item 10 in accordance with the terms in item 10 or such other terms as we may separately agree with you.
F6	<p>Term not specified in the contract</p> <p>Subject to the provisions of this clause 20, the Franchisee will have an option (exercisable only by written notice delivered to Franchisor not more than nine (9) months, but not less than six (6) months, prior to the end of the Term) to renew the Franchise for one further term only (the "Renewal Term"), if and only if:</p> <p>(a) the Franchisee is at the date of exercise of the option to renew in full compliance with this Deed and has not during the Term materially breached this Deed, the lease or licence of the Premises, any other agreement between Franchisor and the Franchisee or any other agreement with other parties which relates to or is incidental to the Franchise;</p> <p>(b) the Franchisee has paid to Franchisor all outstanding amounts due to it;</p> <p>(c) the Franchisee has secured possession of the Premises by lease or licence for the entire Renewal Term;</p> <p>(d) the Franchisee, if required by Franchisor or by the lessor, refurbishes the Premises at its cost to meet the then current design and image, standards and fit-out specifications for new Franchisor Stores, or to the design and image required by the lessor of the Premises and agreed to by Franchisor;</p> <p>(e) the Franchisee must have paid to Franchisor its reasonable cost of renewing the Franchise and if applicable the lease, including reasonable legal fees and expenses incurred in the preparation of all necessary documents, as well as stamp duty on such documents; and</p> <p>(f) the Franchisee enters into the Standard Franchisor Franchise Deed (identified by Franchisor) then being used by Franchisor at the time of the exercise of the option, save that such Franchise Deed shall not contain any further renewal options. The Franchisee must agree to pay the levels of Franchise Service Fees and Advertising Contributions</p>

	<p>applicable at the time to new franchisees (provided that there shall be no further Initial Franchise Fee payable in terms of clause 6.1 and no further contribution to the Advertising Contributions Account in terms of Item 9(a) of the Schedule)</p> <p>20.2 Loss of right to renew The Franchisee will be deemed to have irrevocably lost its right to renew the Franchise (and its or his option shall thereupon terminate) if having given a notice pursuant to clause 20.1 it or he fails to execute and return to Franchisor, the Franchise Deed (referred to in clause 20.1(f)) and other such documents required by Franchisor for a renewal, within twenty (20) Business Days after Franchisor has delivered the Franchise Deed and other documents to the Franchisee for execution.</p>
F7	<p>Term not specified in the contract Conditions of Renewal similar to F6 above: The Franchisee's right to renew the Franchise is subject to and conditional upon satisfaction of each of the following conditions:</p> <ul style="list-style-type: none"> - at the date of giving the notice of renewal and at the end of the current term of the Agreement, there is no outstanding breach of this Agreement or any Related Agreement which has not been remedied; - the Franchisee pays to the Franchisor all amounts owed to the Franchisor by the Franchisee; - the Franchisee pays its suppliers all amounts owed to them by the Franchisee; - the Franchisee pays the Renewal Fee to the Franchisor; - the Franchisee establishes that it has obtained an Occupancy Right to the Premises for the duration of the renewal period; - the Franchisee executes and returns to the Franchisor its then standard franchise agreement (which may contain different terms and conditions to those set out in this Agreement and excluding - in the case of a renewal for the First Further Term, the right to renew for the First Further Term and in the case of a renewal for the Second Further Term, excluding any provision for the right to renew for a further term) and all other documents required by the Franchisor for a renewal within 1 month after the Franchisor has delivered those documents to the Franchisee; <p>the Franchisee, Manager and the key employees of the Franchisee nominated by the Franchisor, at the cost of the Franchisee, complete the then current initial training program to the satisfaction of the Franchisor; and</p> <ul style="list-style-type: none"> - the Franchisee renovates and refurbishes the Premises and replaces or upgrades any plant, equipment, fixtures, fittings and signs as the Franchisor may reasonably require in order to bring the Premises and other assets used in the Business up to the then current standards and specifications of the Franchisor for all new Businesses and to comply with any Laws and the requirements of any authority. <p>(...) RENEWAL FEE The costs and expenses of the Franchisor of and incidental to the grant of the Franchise for the further term, including (without limitation)</p> <ul style="list-style-type: none"> - the costs and expenses of the Franchisor investigating and reviewing the status of the Franchisee and the proposed guarantors; - the legal costs and expenses of the Franchisor on a full indemnity basis of and

	<p>incidental to the preparation and execution of the new franchise agreement and other incidental documents;</p> <ul style="list-style-type: none"> - all filing/registration fees; and - all other reasonable costs and expenses.
F8	10/10 year term and right of renewal.
F9	5/5 year term and right of renewal; Renewal fee \$5000, Right to renew subject to conditions
F10	10/10 year term and right of renewal (few conditions)
F10	<p>Term of Agreement - This Agreement will start on the date of execution and continue for ten years, unless terminated under Clause qq.</p> <p>Option to renew - After ten years the Franchisee may sign, without charge, the then current Franchise agreement for a further ten years, provided that they are not in breach of the Agreement and have no overdue business accounts with anybody. The new Agreement will contain a clause similar to this one, allowing a further ten years.</p>
F11	5/5 year term and right of renewal. Option to renew subject to various conditions
F12	5/5 year term and right of renewal.
F13	Term not specified in the contract /Right of renewal NA
F14	<p>5 year term; renewal term not stated</p> <p>Possible Renewal:</p> <p>At least 3 months prior to the expiry date, we may give a written notice to you stating if we will renew the franchise, and if so, on what terms.</p> <p>If we do give such a notice, you must:</p> <ul style="list-style-type: none"> (a) within 1 month of receiving the notice advise us in writing whether you will accept the terms contained in the notice; and (b) within 14 days of receiving a new Franchise Agreement, sign such Franchise Agreement and return it to us along with any payment that you may be required to make. <p>If we do not give such written notice, either of the following may occur:</p> <ul style="list-style-type: none"> (a) your franchise will not be renewed and you will be required on the expiry date to cease operating the Business and vacate the Business Premises and otherwise comply with the termination provisions of this Agreement; or (b) we may nevertheless enter into discussions and/or negotiations with you concerning the granting of another franchise - this will be entirely at our discretion.
F15	<p>Term not specified in the contract /Right of renewal NA (Annexure A not included in Franchise Agreement)</p> <p>Renewal Fee: \$1 (Schedule Item 15)</p> <p>3.2 Option for Renewal. The Franchisor grants to the Franchisee an option to renew this Agreement and conduct the Franchised Operation for the Renewal Term.</p> <p>3.3 Exercise of Option. The Franchisee shall only be entitled to exercise the option (if any) contained in Clause 3.2 in the event that:</p> <ul style="list-style-type: none"> (a) the Franchisee has at all times during the Term duly observed and performed his obligations under this Agreement and all agreements with the Franchisor and the Leasing Company; (b) the Franchisee upgrades the Premises to meet the then current

	<p>Franchisor Image;</p> <ul style="list-style-type: none"> (c) the Leasing Company has been granted a renewed term under the Head Lease pursuant to an exercise of option or otherwise; (d) the Franchisee has sought a renewal of the Licence; (e) the Franchisee has given written notice to the Franchisor exercising the option not more than nine (9) months and not less than three (3) months before the expiration of the Term; (f) the Franchisee pays the Renewal Fee; (g) the Franchisee is prepared to execute the then current franchise agreement; (h) the Franchisee pays the Franchisors reasonable costs of and incidental to (including legal fees) the preparation of the then current franchise agreement, renewal of the Head Lease and the Licence of the Premises (if allowable at law); (i) the Franchisee undertakes and satisfactorily completes, at its cost, four (4) weeks re-training if requested to do so by the Franchisor at a location nominated by the Franchisor in the reasonable exercise of its discretion; (j) the Franchisee complies with a direction from the Franchisor to permanently remove from the Premises any Asset item or items that no longer form part of the Image and/or System.
F16	10/10 year term and right of renewal. (4.1; Schedule item 3)
F17	<p>Term not specified in the contract</p> <p>Option to renew your franchise You have one option to renew your franchise for the renewal term if you and your associates comply with clause 5.2 and you give us a renewal notice at least 3 months, but no longer than 9 months before this franchise is due to expire.</p> <p>Renewal conditions Before we will grant you a new franchise for the renewal term and after you have exercised the option to renew your franchise in clause 5.1, you and your associates must comply with the following pre-conditions: you and your associates must:</p> <ul style="list-style-type: none"> - not be in default under this agreement at the date you exercise your option and on the expiry date of your franchise; - pay all money due by you and your associates to us and our associates on the date you exercise your option and on the expiry date of your franchise; - sign and return to us all the renewal documents; and - you must pay: <ul style="list-style-type: none"> - the renewal fee to us when you give us the renewal notice; - the reasonable costs (but not more than \$500 plus GST) incurred by us or our associates in reviewing the suitability and financial position of you and your associates; - the reasonable legal costs incurred by us and our associates in negotiation, preparation, signing, delivery, stamping, completing and registration of the renewal documents;

	<ul style="list-style-type: none"> - you must: - reasonably demonstrate to us that you are able to maintain a right to possession, use or occupation of the store for the renewal term or to secure and develop a new store within the protected franchised area at a suitable location reasonably approved by us: - if we reasonably require have your associates or managers undertake any re-training course at your cost; you must at your cost: - before this franchise expires or if we allow, within the first 6 months of the renewal term, do all redevelopment works to the store we reasonably require so long as before the redevelopment works are done we consult with you about the nature of the redevelopment works needed to be done to the store; <p>if we consider reasonably necessary, having regard to the performance of your business at its current location or other relevant facts, you must relocate the store to more suitable premises within the protected franchised area or to a new location within 2km from the centre of the store, so long as before you have to move your business, we have consulted with you about the proposed new location for the store.</p> <p>5.3 Loss of renewal term - If you fail to comply with the preconditions for renewal of your franchise in clause 5.2 after 30 days written notice to do so, we may refuse to renew your franchise and end all agreements with you in connection with the renewal of your franchise. If for any reason your franchise has already been renewed, the failure to comply with any of the preconditions in clause 5.2 will be taken to be a default entitling us to end the renewed franchise agreement.</p> <p>5.4 Renewal documents - The renewal documents may be different to the existing franchise agreement and transaction documents. ...A new franchise agreement will not require the payment of an initial franchise fee but will require you to pay the renewal fee.</p> <p>5.6 No renewal - Despite anything to the contrary in this agreement, we do not have to renew your franchise if: for any reason beyond our control before the start of the renewal term, the store cannot be leased or otherwise made available for use or occupation by you for your business; and you do not, within 6 months of the store becoming unavailable for use or occupation by you, find and secure a right to use or occupy a new store within the protected franchised area suitable for your business and to which your business may be relocated to for the balance of the proposed renewal term.</p>
F18	<p>5/5 Renewal</p> <p>Within six (6) months but not less than two (2) months before the expiration of the Term, the Franchise Owner shall notify Franchisor in writing if it desires to extend the Franchise for the Further Term. Where Franchisor has not received a notice from the Franchise Owner within the required time period, Franchisor shall not be entitled to advise the Franchise Owner that the Franchise has expired unless and until Franchisor sends to the Franchise Owner a written notice advising the Franchise Owner that the Franchise has not been renewed, and allowing the Franchise Owner a further twenty-eight (28) days to exercise</p>

	the Franchise Owner's option to renew. Franchisor will not unreasonably withhold its consent to a request for renewal for the Further Term where the requirements of clause 4.2 have been satisfied.
F19	(a) Subject to the earlier termination of this agreement in accordance with its terms, the Term is a period of three years from the Commencement Date. (b) This agreement will be renewed automatically for successive periods of three years (each a "Renewal Term") unless either party gives to the other not less than three months notice prior to the end of the Term or the Renewal Term (as the case may be), that it will not be renewing the agreement after the Term or the then current Renewal Term.

Discussion of results

The initial contract duration in the sample varied from five to ten years; no contract in this sample was of duration longer than ten years. Most contracts sampled did contain a right of renewal. The most commonly-used formula in the contracts sampled is the five-year initial contract duration with an option to renew for a further five years.⁵⁰⁶ All contracts sampled offered an option to renew for one term of the same length as the initial term; none offered a further option to renew. Some provisions were made for month-to-month operation after the expiration of the initial term. Variations among these terms related principally to the notice period for renewal, renewal fees and other conditions for renewal.

To address franchisor concern that the 'right of renewal' might create a property right in a franchisee, most of the terms in this sample include extensive conditions that can be imposed by a franchisor to prevent a franchisee from acquiring a property right or other right that is onerous to a franchisor.⁵⁰⁷ These conditions allow a franchisor to refuse to grant renewal where a franchisor may have an interest in limiting the power and influence of existing franchisees, for example, in major or geographically extensive markets, or where, for these and other reasons, there is a potentially strong

⁵⁰⁶ In Europe most franchisee agreements run for a period of between five and ten years but 'Pan EU agreements are usually longer between 10 and 25 years', in order for the franchisee to obtain a decent return on its investment.

⁵⁰⁷ Because a contractual relationship of limited duration becomes property right – 'statutes that limit the franchisor's right not to renew...impinge upon the substantive economic rights of the parties'. See Rupert M. Barkoff, *Government Regulation of the Franchise Relationship in the United States* (2003) Kilpatrick Stockton LLP <<http://www.kilpatrickstockton.com/publications/pubs.aspx>> at 15 August 2003.

franchisee that may no longer comply sufficiently or may threaten a franchisor's control.⁵⁰⁸

Only one contract in the sample, F19, provides for an automatic renewal that can be declined by either party with three months' notice. If the contract were to reflect a balance of power between the parties, contract duration terms could be expected to be calibrated to protect and allow recovery of a franchisee's specific investment while safeguarding a franchisor from franchisee free-riding.⁵⁰⁹ It is not clear whether the five-year initial term with five-year right of renewal does create such a balance but shorter contract terms do tend to favour a franchisor, and most of the contracts in the sample provide for short contract terms. The sample therefore indicates that the contract reflects an imbalance of power between the parties.

The scope for franchisor discretion in determining conditions for renewal is difficult for a prospective franchisee to assess but can have a significant impact on a franchisee's return on its investment. Long-term contracts are in theory associated with uncertainty, but shorter contract duration in the long-term contract also creates uncertainty for a franchisee. Not only is a franchisee in this situation giving discretion to a franchisor over the period of the initial term, but also a franchisee is subject to franchisor's conditions, often exercised with a franchisor's discretion, at the expiration of the initial term. For example, a common renewal condition is to require a franchisee to sign the "then current" form of the franchise contract, which is likely to include higher fees as well as new restrictions on the operation of the business. A franchisee may be required to update the physical plant of the business to the current basis for new units opening in the system, a potentially major investment.⁵¹⁰ As franchisees approach the expiration of their term they may be

⁵⁰⁸ *The Franchise Agreement* (2005) European Franchising Network
<<http://www.europeanfranchising.com/introtofranchising/14franchiseagreement.aspx>> at 30 December 2005.

⁵⁰⁹ Janet Bercovitz, 'An Analysis of the Contract Provisions in Business Format Franchise Agreements' (1999) International Society for New Institutional Economics
<<http://www.isnie.org/ISNIE00/Papers/Bercovitz.pdf>> at 8 December 2004.

⁵¹⁰ Jeff Elgin, 'Ready to Commit? About to buy a franchise but intimidated by the licence agreement? We explain what to look for before you sign on the dotted line' (2005) Entrepreneur.com
<<http://www.entrepreneur.com/article/0,4621,321573,00.html>> at August 2005. See also; 'The Problems Franchisees Face' (2003) American Franchise Association
<<http://www.franchisee.org/problem>> at 30 December 2005.

subject to franchisor pressure to conform in a variety of ways as a condition of renewal.⁵¹¹

Case law

Most case law that is available regarding right of renewal in franchising involves petrol stations.⁵¹² Several of these cases suggest that the terms of contracts are often constructed so that a franchisor does not have to renew, as the court found that there was not a right of renewal enjoyed by the franchisee. Because these are governed by a separate code,⁵¹³ they are not discussed further here.

Direct intervention in contract duration and right of renewal

Some jurisdictions impose substantive requirements with respect to this term. In some provinces in Canada the right of a franchisee to renew is protected by legislation.⁵¹⁴ Several countries now have legislated mandatory minimum contract duration.⁵¹⁵ With respect to the initial term of franchise agreements Indonesia and Malaysia require a minimum five-year term. The minimum term in Italy is three years.⁵¹⁶

In Australia there is no substantive statutory requirement with respect to term and franchisee right of renewal. There is no regulatory requirement that protects a franchisee's right to renew, and there are no substantive requirements with respect to a franchisor's imposition of conditions on right of renewal. Common law rules apply; the courts are left to assess what is reasonable in the franchise relationship, informed

⁵¹¹ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 116.

⁵¹² These cases include *Ampol Ltd v Calaby Pty Ltd* (1991) 110 ALR 343, *Sagittarian Enterprises Pty Ltd and Others v Ampol* (1986) 69 ALR 551, *Anjac Pty Ltd v Caltex Oil Australia Pty Ltd* (1985) 69 ALR 733, *Mobil Oil Australia Ltd v Brian Brindle* (1983) 62 ALR 89, *Dinyarrak Investments Pty Ltd v Amoco Australia Ltd* (1982) 45 ALR 214.

⁵¹³ See the *Petroleum Retail Marketing Franchise Act 1980* (Cth).

⁵¹⁴ See, e.g. Valas and Associates, *A F5D Standards Regulating Term and Renewal* (2005) Valas and Associates <<http://www.franchiseelaw.com/term.html>> which outlines right of renewal "ROR"; Cyber Frontier eBusiness, *Franchise Agreement* (2003) <<http://www.cyberfrontier.biz/en/cfc-cb-franchise-sept03.pdf>> which provides a sample contract with ROR; <<http://www.nig.co.uk/fabout.html>>. See also the 2000 amendment to the *The Arthur Wishart Act (Franchise Disclosure), 2000* <http://www.ontla.on.ca/documents/Bills/37_Parliament/Session2/b138_e.htm> which protects franchisees against franchisor non-renewal in Canada.

⁵¹⁵ Interview with Lorelle Frazer, Associate Dean, Postgraduate Studies, Griffith University at the FCA Conference, 2003.

⁵¹⁶ In Europe some legislation reportedly provides for a maximum term. See <<http://www.europeanfranchising.com/>>.

in the process by criteria contained in TPA section 51AC and the developing doctrine of good faith in contract performance. Statutory regulation of this contract term, Disclosure Item 17, requires only a summary of the relevant conditions of the franchise agreement.

FCC Disclosure 17, Summary of other conditions of agreement, provides as follows:

17.1 Summary of the conditions of the franchise agreement (or references to the relevant conditions of the franchise agreement, if attached) that deal with the following matters:

(a) term of the franchise agreement; (...)

(c) renewal or extension;

(d) conditions the franchisee must meet to renew or extend the franchise agreement;...

Disclosure under the Code provides no more information to a franchisee than the contract itself as to the nature of the conditions that will be required by a franchisor for renewal. A franchisor enjoys flexibility to make changes to the system and to require compliance by a franchisee with the new terms, though a franchisee cannot predict and has no say in what those terms might involve.

Summary and measures to address imbalance of power and lack of certainty in term/franchisee right of renewal

There should be clearer understanding on both sides of how long the individual franchisee needs to be in business to recoup its investment.⁵¹⁷ To enhance certainty for a franchisee the initial duration of the contract should be sufficient to provide a franchisee return on investment. This contract term may be one instance where individual franchisee circumstances should play a greater role in negotiations. Customising these provisions could accommodate the investment and demographic profiles of individual franchisees and the likelihood of meeting their overall business objectives.

Certainty could also be improved through clearer understanding on both sides of what needs to happen for a franchisee to exercise a right of renewal. Currently, a franchisor can set conditions at the time of renewal and a franchisee has no advance knowledge of what a franchisor's conditions for renewal are likely to be. A franchisee needs greater certainty in the form of specification of what a franchisor can require and/or some input in the process.

To improve balance of power collective action could be beneficial in instituting consultation processes that include franchisees; thus better ensuring franchisees' interests are served. Not only could this help insure against franchisor abuse, but could protect a franchisor from exposure to liability under the TPA section 51AC. This could be a benefit to franchisors of consultative processes generally, not only in the negotiation of term and right of renewal.

⁵¹⁷ Similarly, the costs and the requirements of the franchisor must be based on the contract duration and franchisee's expected return. These figures would vary widely depending upon the type of industry, the size of the unit, etc.

5.5 CONTRACT TERM: FRANCHISOR OBLIGATION TO ADVERTISE

Maintenance of brand and trademark is a critical aspect of the success of any franchise system. Franchisor promotional obligations build and reinforce brand and trademark. They also can help to curb franchisee free-riding by centralising brand maintenance for the system, while a franchisee may undertake local promotions on behalf of the unit. Franchisee participation in promotional funding is mandatory. Promotions are paid for with funds a franchisor collects from franchisees. A franchisor may allocate funds at its discretion for advertising and promotions.⁵¹⁸

Advertising is one of the few explicit contractual obligations of a franchisor, but it is an obligation undertaken at a franchisor's discretion; a franchisor

‘shall oversee all System and Product advertising, with sole discretion to approve or disapprove the creative concepts, materials and media used in such advertising, and the placement and allocation thereof.’⁵¹⁹

This situation where one party that provides an asset that is vulnerable to the actions of the other party exercising control over the asset presents a classic case of opportunistic risk. A franchisee is vulnerable to several forms of franchisor opportunism in promotional activities. There is, for example, no contractual provision to restrict spending on promotions that increases the revenues of franchisors, but not those of franchisees. Contracts are often drafted so that a franchisor is not required to spend advertising dollars in the market where franchisees have contributed to the funds. A franchisor can use the funds to advertise heavily in areas served by company stores or those served by favoured franchisees. Franchisees therefore need assurance that franchisors will fulfil this crucial obligation to its franchisees.

The following hypothetical illustrates a problem that arises with respect to franchisor control over promotions:

Suppose a franchisor in the exercise of this discretion offers thirty-five percent off all products in a state-wide promotion. Volume will increase but profit

⁵¹⁸ Rupert M. Barkoff and Andrew C. Selden (eds), *Fundamentals of Franchising* (1997) 60; note that franchisees must beware to avoid price-fixing and related anti-competition regulations, but see *Leegin Creative Leather Products Inc. v. PSKS Inc.* (2007), The Oyez Project, Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. ____ (2007), available at: <http://www.oyez.org/cases/2000-2009/2006/2006_06_480/> Tuesday, September 4, 2007. Note also that in addition to funding franchisor's promotions for the brand, a franchisee has an obligation to promote locally.

⁵¹⁹ System F1.

margins may be reduced or wiped out altogether. A franchisor gains because its royalties are based on volume. Franchisees, whose remuneration is based on profits (which can be calibrated by a franchisor to run at the narrowest of margins) may lose money. A franchisor in such a situation may assure concerned franchisees that the decline in profit margins will be made up in volume, but franchisees report that in reality this is often not the case, and that those paying high royalties are particularly burdened.⁵²⁰ There is nothing franchisees can do, however, because marketing expenditures are expressly left to a franchisor's discretion.

Table 5.5: Summary of Franchisor Obligation to Promote in Contracts under Review

Franchise system	Franchisor obligations with respect to advertising
F1	<p>Recognising the value of advertising and promotion, and the importance of the standardisation of advertising and promotion programs to the furtherance of goodwill and public image of the System and Products in Australia, the parties agree as follows:</p> <p>... Franchisee shall contribute monthly</p> <p>... (franchisor) shall oversee all System and Product advertising, with <i>sole discretion</i> to approve or disapprove</p> <p>... Franchisee agrees to expend each year, for local advertising and for promotion, and in addition to the Advertising Amount, an amount equal to one-half of one percent (0.5%) of its annual gross sales.</p> <p>... Franchisee shall participate in all sales promotion programs as required from time to time by (franchisor)</p>
F2	<p>Franchisor will undertake, subject to the limitations of the amounts of the Marketing Contributions available in the Marketing Fund, all other marketing as it decides is reasonably necessary...</p> <p>The Franchisor:</p> <p>(a) may in its sole discretion from time to time advance moneys to the Marketing Fund;</p> <p>(b) will before making any advance to the Marketing Fund seek the approval of the franchisees;</p> <p>(c) will be entitled to interest payable on moneys advanced at the rate of interest payable and terms of repayment agreed to by the franchisees;</p> <p>(d) is entitled to a refund of all moneys advanced by the Franchisor from the Marketing Fund and repayment of these moneys will be a proper payment of advertising expenses under this Agreement;</p> <p>(e) and the Franchisee acknowledges and agrees that the total contributions to the Marketing Fund need not be spent in the year in which they are</p>

⁵²⁰ This scenario was reported to have occurred in a major US eyewear franchise system. See Laura M. Holson, *Have We Got a Deal For You: The Hidden Truth About Franchising* (1996) Zarco Einhorn Salkowski & Brito P. A. <<http://www.zarcolaw.com/CM/News/news46.asp>> at 30 December 2005.

	<p>received and that a reserve in the Marketing Fund may be accumulated by the Franchisor for future promotions;</p> <p>f) will be entitled to administer the Marketing Fund as it deems appropriate and will not be obliged to expend a proportionate part of the Marketing Contributions received from any other franchisee on any particular franchisee or territory but the Franchisor must act fairly in the interests of all franchisees and the Franchisor to ensure REASONABLE and consistent coverage in all territories operated by franchisees and the Franchisor;</p> <p>(g) is entitled to delegate its responsibilities relating to marketing and advertising, contained in this clause, to one or more parties of its choosing;</p> <p>(h) must keep a proper set of books of account relating to moneys paid to it for Marketing Contributions and will accurately maintain them;</p> <p>(i) may establish a marketing consultancy or contract with a marketing consultancy to co-ordinate and assist in the marketing, promotional and advertising initiatives and requirements of the Franchisee (provided the Franchisor will not appoint a marketing consultant without the prior consent of the Franchisee);</p> <p>(j) may require the Franchisee to pay all costs associated with the products and promotional materials provided by that consultancy at the request of the Franchisee, in addition to the contributions to the Marketing Fund made by the Franchisee; and</p> <p>(k) will prepare the annual financial statement required to be prepared under the Code and will have that statement audited in accordance with the Code unless 75% or more of the franchisees contributing to the Marketing Fund give Notice to the Franchisor that they do not want it audited.</p>
F3	<p>Franchisor may provide merchandising, marketing and advertising research data and advice developed by the Franchisor from time to time;</p> <p>The Franchisor may: refuse to approve proposed advertisements and promotional material; and revoke previous approvals of advertisements and promotional material.</p> <p>The Franchisee must: (a) use its best endeavours to promote the Franchise Business in accordance with the System; (b) use only advertising materials prepared by or on behalf of the Franchisor or prepared by the Franchisee and approved by the Franchisor before use; and (c) spend not less than 2% of its Gross Receipts on promoting the Franchise Business.</p> <p>S.9.2 Refusal/revocation of approval The Franchisor may: (a) refuse to approve proposed advertisements and promotional material; and (b) revoke previous approvals of advertisements and promotional material.</p> <p>S.9.3. Franchisee's obligations The Franchisee must: (a) take part in any special promotional programs sponsored, adopted or arranged by the Franchisor or, if required by the terms of the Franchisee's lease, licence or other tenancy agreement, the landlord of the Location; (b) comply with advertising laws and with advertising standards established or endorsed by the Franchisor from time to time; (c) immediately remove or stop using any material for which the Franchisor</p>

	has revoked approval; and (d) advertise at its cost (with other franchisees if requested) in such business directories as the Franchisor may prescribe.
F4	Franchisor on behalf of its franchisees will establish an advertising fund to cover the costs of carrying out such advertising, promotion and/or marketing as the Franchisor decided, in its sole discretion, to be appropriate or desirable to promote the System.
F5	You agree to participate in any national advertising campaign or national promotion that we undertake....Whilst we will consult you regarding major elements of our advertising and promotion, all decisions relating to this advertising and promotion will be made by us and you will be bound by these decisions...You will pay us the marketing levy... we are not responsible for the effectiveness or success of such advertising, promotion or marketing expenditure... you will take part in special advertising and promotional activities reasonably required by us...
F6	Franchisor will provide product and promotional advice from time to time. The Franchisee will actively and diligently promote the Franchised Operation.
F7	The Franchisor must use its reasonable endeavours to promote the Network.
F8	The Licencee shall be solely responsible for the cost of advertising or marketing initiated by the Licencee but such advertising and marketing must be approved in writing by the Licensor prior to its initiation and all advertising and marketing conducted by the Licensor shall be paid for by the Licensor. The Licensor may formulate and implement advertising and promotional programs from time to time as determined by it in respect to Services and Products to the Licenced Operation. The Licensor shall conduct those advertising campaigns and other promotional activities for the Services and Products offered to the public through both licensor and the Licencee.
F9	The Franchisor hereby covenants and agrees to (...) assist the Franchisee with advertising and promotions from time to time when requested, and to supply the Franchisee with advertising or promotional material if and when available; The Franchisee hereby covenants and agrees at its own expense, to do and/or perform each of the following: (...) the Franchisee shall expend annually on local advertising and promotion of the Business, a minimum amount equal to such amount as may be required to be expended under the Lease. Subject to the right of the Franchisor at any time to require the Franchisee to submit all advertising and promotions to be used by the Franchisee to it for prior approval, the Franchisee shall have the right to conduct such advertising and promotions in connection with the Business, as the Franchisee in its reasonable discretion so desires, provided that any advertising and promotions, (i) shall be conducted only in a manner reflecting favourably upon the Business, and the Franchisor, (ii) shall not be deceptive, untrue or otherwise misleading in any way, (iii) shall use the Trademark only in its proper form and

	<p>(iv) shall not be inconsistent with the quality and general over-all advertising and promotional campaigns being used in connection with the Franchisor System.</p> <p>If the Franchisor in its sole discretion determines that the advertising and/or promotions being employed by the Franchisee do not comply with any of the foregoing provisos, the Franchisee shall cease forthwith all use of such advertising and/or promotions. Further, notwithstanding the foregoing,</p> <p>(i) if the aforesaid provisos are not being complied with, or</p> <p>(ii) if such advertising and/or promotions are in the opinion of the Franchisor, detrimentally affecting the business in any manner of another franchisee' of the Franchisor, or of the Franchisor itself, or</p> <p>(iii) if for any reason the Franchisor desires to conduct the local advertising and/or promotions of the Franchisee, the Franchisor shall have the right at any time in consultation with the Franchisee to conduct all advertising and/or promotions being conducted or to be conducted by the Franchisee, on behalf of and at the expense of the Franchisee; in conducting any such advertising and/or promotions on behalf of the Franchisee, the Franchisor may carry out same solely for the benefit of the Business and/or in co-operation with advertising and/or promotions being conducted by the Franchisor for its own retail sales outlets and/or advertising and/or promotions being conducted by others who operate retail sales outlets using the Franchisor System and the Trademark, provided in the latter 2 instances such advertising and/or promotions shall be conducted in either the Franchisee's direct market area and/or the Franchisee's appropriate regional market area as determined by the Franchisor in consultation with the Franchisee;</p> <p>with respect to payment for such advertising and/or promotions, if the Franchisor so exercises this right, the Franchisee shall pay to the Franchisor monthly, in advance, together with the royalty fee payable pursuant to clause 3.1 (2) hereof, an amount equal to such amount as the Franchisor in consultation with the Franchisee determines is, to be spent to conduct such advertising and/or promotions for the subsequent month;</p> <p>the manner, media and cost of such advertising and/or promotions shall be solely within the discretion of the Franchisor;</p> <p>for providing the foregoing services, the Franchisor shall be entitled to receive an administration fee equal to 150/0 (sic) of the amount in fact expended in connection with such advertising and/or promotions, as well as to be reimbursed for all disbursements incurred by it;</p> <p>all amounts so collected as provided above (less amounts payable for the administration fee and disbursements) shall be used in connection with advertising and/or promotions;</p> <p>no later than 21 days after each calendar quarter in which the Franchisor has so conducted such advertising and/or promotions, the Franchisor shall give to the Franchisee a statement setting out particulars as to the expenditures of the amounts so paid by the Franchisee pursuant hereto.</p> <p>(15) in addition to the advertising and promotions to be conducted as set forth in subclause (14) above, the Franchisor shall have the right at any time as it shall determine, to levy upon the Franchisee a national advertising and/or promotional appropriation equal in amount to 1% per annum of the Franchisee's Gross Revenue. In the event the Franchisor so exercises this right, the</p>
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	<p>Franchisee shall pay to the Franchisor monthly, in advance, together with the royalty fee payable pursuant to clause 3.1 (2) hereof, an amount equal to 1%, of the Franchisee's Gross Revenue for the immediately preceding month. The manner, media and cost of such advertising and/or promotions shall be solely within the discretion of the Franchisor. For the services provided by the Franchisor herein, the Franchisor shall be entitled to receive an administration fee equal to 15% of the amount in fact expended in connection with such advertising and/or promotions, as well as to be reimbursed for all disbursements incurred by it. All amounts so collected (less amounts payable for the administration fee and disbursements) shall be used in connection with such national advertising and/or promotions. No later than 3 months after the end of each calendar year in which the Franchisor has so conducted such advertising and/or promotions, the Franchisor shall give to the Franchisee a statement setting out particulars as to the expenditures of the amounts so paid by the Franchisee pursuant hereto; ...</p>
F10	<p>The Regional Franchisor must apply the monthly Advertising Fee for the purpose of advertising and promoting the Franchise Businesses and for the mutual benefit of that Franchise Business and such other Franchise Businesses associated with the National Franchisor within the Region (including purchasing goodwill) as the Regional Franchisor may in its absolute discretion decide.</p> <p>The Regional Franchisor agrees to prepare and provide financial statements relating to the Advertising Fee for the preceding Financial Year and to provide same to the Franchisee upon request.</p>
F10	<p>The Franchisor must apply the monthly Advertising Fee to finding work for Franchisees in the Region. Each Franchisee should receive an account of advertising income and spending within sixty days of the end of the financial year.</p> <p>The Franchisor will make reasonable efforts to find the Franchisee client leads, and to spend the Advertising Contribution in an effective manner. Franchisees should be regularly consulted on the spending of the Advertising Fee, though the Franchisor has the final say.</p>
F11	<p>Franchisor will conduct any advertising it considers appropriate from time to time at its expense.</p> <p>The franchisee will not be required to contribute to a central advertising fund. Franchisor may elect to conduct advertising to which the franchisee may be requested to contribute to the cost of conducting. The parties must agree on the franchisee's share of the costs before the promotional activities are conducted. The franchisee must actively promote its Business as required by the Tool Kit.</p> <p>Restriction on Advertising –</p> <p>Without limiting clause 9.3, for each advertisement or promotional activity, the franchisee must:</p> <ul style="list-style-type: none"> (a) first obtain Franchisor' written approval; (b) not use any Mark without the prior approval of Franchisor; (c) not engage in any activity or commit any act which is likely to jeopardize the reputation of Franchisor' Business in any way; (d) indemnify Franchisor against any loss or damage to any Mark by reason of

	<p>its use other than as set out in this Agreement and the directions or consents of Franchisor; and</p> <p>(e) not advertise or promote its Business outside Australia without the consent of Franchisor.</p> <p>Marketing Plan – Each year, within one (1) month of the anniversary of the Commencement Date, the franchisee must prepare and give to Franchisor its Marketing Plan for approval by Franchisor. If Franchisor does not approve the plan, it will meet with the franchisee as soon as it can after receipt of a Marketing Plan to discuss and finalise variations to the Marketing Plan so that it can be implemented by the franchisee as soon as possible.</p>
F12	<p>7 Advertising</p> <p>7.1.1.2 The Franchisee may conduct such marketing, advertising or promotion as it considers reasonably necessary in the conduct of the Business provided that such marketing or promotion complies with all relevant laws and has first been approved by the Franchisor.</p> <p>7.1.1.3 The Franchisor may from time to time conduct marketing or advertising campaigns, but is under no obligation to do so. The Franchisor may require the Franchisee to contribute to the cost of such campaign, provided that:</p> <p>7.1.1.3.1 The Franchisee may reasonably be expected to receive some direct or indirect benefit from the campaign; and</p> <p>7.1.1.3.2 if more than one Franchisee is asked to contribute, the contribution is equal as between the Franchisees. The Franchisee must:</p> <p>7.1.1.3.3 Participate in all promotions the Franchisor reasonably requires;</p> <p>7.1.1.3.4 Comply with all reasonable directions of the Franchisor about advertising, marketing and promotions;</p> <p>7.1.1.3.6 Not provide any Products or Services being advertised by the Franchisor at prices higher than the prices advertised.</p>
F13	<p>Franchisor must provide franchisee with advice and information to promote and market the products.</p> <p>...</p> <p>Franchisor must arrange advertising campaigns and other promotional activities for the products and services offered to the public and use advertising contributions made by you and other franchisees in the campaign.</p>
F14	<p>We will market the Business and products sold by our franchisees in such manner as we see fit. This may include:</p> <p>(1) a national or local advertising campaign;</p> <p>(2) promotions and displays at locations we choose;</p> <p>(3) sponsorship of events or persons with high profile;</p> <p>All expenses incurred by us in connection with marketing and promotion will be funded by advertising contributions paid by you and other franchisees</p>
F15	<p>4.1 Franchisor Covenants. The Franchisor covenants and agrees with the Franchisee, as follows: ...</p> <p>(d) Marketing. To apply all Marketing Contributions received from Franchisees to the National Marketing Fund which will be applied towards Marketing;</p> <p>...</p> <p>The Franchisor has established a separate bank account known as the National Marketing Fund and shall operate this account to pay the costs of Marketing in</p>

	<p>such manner as the Franchisor, in its sole discretion, deems appropriate ...</p> <p>Marketing Contribution. The Franchisee shall pay the Marketing Contribution to the Franchisor for deposit into the nominated National Marketing Fund bank account. The Marketing Contribution shall be paid by the Franchisee by the first Friday following the end of each Accounting Week.</p> <p>All Marketing Contributions shall be exclusively used for Marketing including such agency fees and reasonable overhead and administrative costs as the Franchisor may incur in connection with the administration of the National Marketing Fund.</p> <p>The Franchisee acknowledges and agrees that the total of all marketing contributions from all Franchisees to the National Marketing Fund need not be spent in the year in which the contributions are received, and that a reasonable reserve may be accumulated in the National Marketing Fund, and further acknowledges that upon the termination of this Agreement it shall not be entitled to claim any part of the monies standing in the National Marketing Fund.</p> <p>The Franchisee acknowledges that the Franchisor is entitled to administer the National Marketing Fund as it deems appropriate and is not obliged to expend a proportionate part of the Marketing Contributions in any area or on behalf of any particular Franchisee or territory provided that the Franchisor will use its best endeavours to ensure that all franchised territories are given good marketing coverage. The Franchisor will not invest any Marketing Contributions in any prescribed interest or invest or lend these contributions to the Franchisor or any company related to it.</p>
F16	<p>Advertising seems to be the obligation of the Franchisee rather than the Franchisor, i.e. -</p> <p>The Master Franchisee must at all times actively and diligently develop and promote the Franchisor' Franchise in the Master Franchise Area specified in Schedule 5.</p>
F17	<p>We will set up and keep a marketing fund by opening a separate, general business account called "Franchisor Marketing Fund" or another name chosen by us. This account will not be a trust account. You have no control over the way we use the marketing fund.</p> <p>We will deposit the marketing levies into the marketing fund and keep records about the marketing fund.</p> <p>During the franchise term, we may control, manage, spend, use or apply the marketing fund for any purpose we see fit...</p> <p>You and your associates agree that:</p> <ul style="list-style-type: none"> • the marketing fund can be used to improve and promote public recognition and acceptance of the trade marks; • money in the marketing fund need not be spent nor committed in the year in which it is received; • we may if we consider it appropriate accumulate a reasonable

	<p>reserve of money in the marketing fund. methods of allocating the use of marketing levies between Franchisor stores may vary and may not be the best nor fairest use of the marketing fund;</p> <ul style="list-style-type: none"> • we will solely decide as to creative form, content, endorsement and media use, type and nature of all advertising, marketing and promotions to be undertaken and relevant budgets with respect to them. <p>During the franchise term, we do not have to:</p> <ul style="list-style-type: none"> • consult with you about the advertising or marketing plan to be adopted by us; • give you a refund from the marketing fund even if we do not spend all of the money in the marketing fund; • invest the money in the marketing fund; • make the benefits you or anyone else get from the marketing fund equal or proportionate to the marketing levies you or anyone else have paid into the marketing fund; • make sure that you or your business benefits directly from use of the marketing fund, <p>During the franchise term, we may:</p> <ul style="list-style-type: none"> • control how the trade names and trade marks are used by you in connection with any marketing, advertising or promotions; • decide when and how to use the marketing fund between Franchisor stores; • choose the areas that are to be covered by any marketing, advertising or promotions: and • delay or waive the collection of marketing levies from anyone or more of our franchisees or anyone else. <p>We will keep separate accounts with respect to the marketing fund and at your request, within 6 months after the end of each tax year during the franchise term, provide you with reasonable accounting details about the money received and spent in connection with the marketing fund.</p> <p>...</p> <p>You and your associates agree that we will own, maintain and control a database of the Franchisor VIP customers and members. We may use that database in any way we see fit.</p>
F18	<p>Franchisor will not engage in any direct marketing specifically targeted at the Franchise Owner's Clients.</p> <p>Franchisor will not use for direct marketing any database of the Franchise Owner's.</p> <p>The Franchise Owner acknowledges and accepts that Franchisor has, and will continue to develop, many databases. Where any direct marketing by Franchisor is proposed using any database which it is foreseeable may contain Clients of the Franchise Owner, Franchisor will consult with the elected representatives of the Franchise Owner, currently the Franchisor Franchise</p>

	<p>Trust, and will develop procedures to ensure the interests of the Franchise Owners are considered in all marketing initiatives.</p> <p>For the purposes of clauses 3.6 to 3.9, "direct marketing" means marketing to an individual or group and does not include media advertising or promotions or any marketing to the public.</p> <p>Responsibilities of Franchisor Franchisor will during the Term, build a strong Franchisor brand awareness relevant to the Approved Products and the Approved Services.</p> <p>Marketing, Advertising and Promotions The Franchise Owner shall be responsible for the advertising, marketing and promotion of the Franchised Business.</p> <p>Marketing and Business Plan – The Franchise Owner shall be responsible to achieve the advertising, marketing and promotional objectives and carry out the strategies and activities described in the Marketing and Business Plan in a manner consistent with the overall strategies set by Franchisor.</p> <p>...</p> <p>Franchisor Marketing of Brand - Franchisor shall market the Approved Products, the Approved Services and the Franchisor brand so as to build strong brand awareness.</p>
F19	<p>During the Term the Company will:</p> <ol style="list-style-type: none"> (1) use all reasonable efforts to protect the Retail Brand, its image and reputation and promote public awareness of the Retail Brand; (2) undertake retail promotions as gazetted in the promotional calendar communicated to the Member at the commencement of the promotional year and as amended by the Company from time to time; (3) undertake to advise the Member of participation or involvement in any public relations activity and media programs which may from time to time include, without limitation, television, radio, or print media; (4) prepare and distribute from time to time a newsletter containing information about the Retail Brand marketing systems, programs, pharmacies, activities, products and services; (5) at least once each year, provide an opportunity for the Member to meet other licenced users of the Retail Brand and discuss as a group the activities and programs associated with the Retail Brand; (6) develop and offer to the Member programs to encourage consumer loyalty as detailed in the Program Guidelines; (7) from time to time, provide promotional merchandising materials for use by the Member at the Location, as detailed in the Program Guidelines.

Discussion of results

Most contracts state here or elsewhere a franchisee's obligation to pay into a marketing fund to be administered by a franchisor. The schedules for these amounts

are often contained in other documents, but the F9 contract states that in addition to the amounts a franchisee must pay for local advertising, it must pay a percentage into the national fund along with a 15% administration fee to the franchisor.

Eight of the contracts sampled, F2, F4, F7, F11, F15, F17, F18, and F19, list franchisor obligations regarding promotion by stating that the franchisor ‘shall’, ‘will’ or ‘must’ engage in some promotions or brand maintenance but every one of these contracts qualifies this obligation, according discretion to a franchisor with permissive language to the effect that a franchisor may engage in advertising and promotion as it determines to be ‘reasonably necessary’ (F2), ‘as it deems appropriate’ (F11), or it will apply reasonable endeavours or efforts (F7, F19). F8, and F12 state that the franchisor may advertise, as it considers reasonably necessary (F12).

F4, F15 and F17 state that the franchisor will set up or administer a marketing fund. F10 states that the franchisor will apply the franchisees’ advertising fees to promotions. F2, F9 and F13 state that the franchisor will advise or assist franchisees with promotions, but qualified with language such as ‘if and when available’ (F9). F2 states that it will be entitled to reimbursement and may delegate this function and require a franchisee to pay all costs.

Franchisor obligation in this contract term is stated in vague terms and/or is subject to a franchisor’s discretion, ‘...the manner and style of advertising and promotion together with their frequency will be determined in the absolute discretion of the Franchisor.’⁵²¹ A franchisor’s discretion may include the ability to delegate the function; a franchisor may administer the program directly or set up trust or corporation to administer.⁵²²

Also, this clause does not ensure adequate investment by a franchisor in brand maintenance, as the following two excerpts illustrate: ‘... the Franchisor may determine in its discretion how the Marketing Fund is spent’⁵²³ and ‘...the Franchisor operates that account for the purposes of and to pay for the costs of developing, publishing, operating and administering, advertising, public relations and promotional

⁵²¹ System F2.

⁵²² System F2’s contract expressly allows a franchisor to delegate advertising responsibilities.

⁵²³ System F7.

material and programmes in such manner as the Franchisor in its sole discretion deems appropriate for the benefit of the Franchise System, the Franchisee and all other franchisees.⁵²⁴

If a franchisor's circumstances are such that promoting the brand becomes a lower priority, either for a franchisee's territory or for the entire franchise system, a franchisee has little recourse. If a franchisor is rapidly expanding, for example, or if a franchisor is in a cost-cutting phase, a franchisee may lose franchisor brand support.⁵²⁵

This clause could be presented to a prospective franchisee as offering protection against franchisor opportunism, such as inadequate investment by a franchisor in promotion, but given the level of discretion with which such clauses are qualified, the practical effect is that they offer maximum latitude to franchisors with little protection or assurance to franchisees. In fact, several contracts (See F15 and F17) expressly provide that a franchisor has no obligation to spend the funds, and the franchisee nevertheless has no claim to these funds.

On balance these clauses delegate to a franchisor maximum latitude with minimum obligation (see Table 5.9). Some discretion is necessary because at the time the contract is signed, no one knows what sorts of promotions will be required. Because a franchisor's interests are not coterminous with those of its franchisees, however, franchisees' total lack of control in this function can reinforce franchisee uncertainty and compound franchisee vulnerability to franchisor opportunism.

⁵²⁴ System F2.

⁵²⁵ Telephone interview with Nick Heys, National Manager, Franchising and Small Business, Australian Competition and Consumer Commission (2004).

Case law

In *Mark Clifford and Ors v Eagle Boys Dial-A-Pizza Australia Pty Ltd*,⁵²⁶ the franchisee owned two pizza operations, and decided to join Eagle Boys. The franchisee also took over some franchise operations from other Eagle Boys franchisees. Tension developed between the franchisor and the franchisee in a number of areas including advertising and marketing activities. The franchisee claimed that the amounts expended by the franchisor and the nature of the expenditures were inadequate, rendering the agreement unfair.⁵²⁷ The court held that the applicants did establish unfairness.

In *Sunice v Wendy's Supa Sundaes and Anor*,⁵²⁸ the plaintiff, a franchisee, sought summons for all advertising money paid by the plaintiff to the defendant, as the plaintiff was dissatisfied with promotional proposals and a change in direction of franchised shops proposed by the master franchisor. The court ordered mediation, as the most recent franchise agreement provided for dispute resolution. Because the results of mediation are confidential, the disposition of this case is not known.

⁵²⁶ *Mark Clifford and Ors v Eagle Boys Dial-A-Pizza Australia Pty Ltd* [2000] NSWIRComm 30.

⁵²⁷ Other issues included Section 106 Industrial Relations Act, unfairness brought by applicants with respect to franchise agreements, the pricing scheme.

⁵²⁸ *Sunice v Wendy's Supa Sundaes and Anor* [1998] QSC 223.

Direct intervention in franchisor advertising

A franchisor's obligations with respect to brand maintenance are regulated exclusively through disclosure and reporting requirements. These are contained in Disclosure Item 12 and Sub-Clause 17, which are reproduced here:

FCC Disclosure Item 12: Marketing or other cooperative funds

12.1 For each marketing or other cooperative fund, controlled or administered by or for the franchisor, to which the franchisee may be required to contribute, the following details:

- (a) the kinds of persons who contribute to the fund (for example, franchisee, franchisor, outside supplier);
- (b) whether the franchisor must contribute to the fund in relation to businesses owned or operated by the franchisor that are substantially the same as the franchised business and, if so, whether the contribution is worked out in the same way as for a franchisee;
- (c) how much the franchisee must contribute to the fund and whether other franchisees must contribute at a different rate;
- (d) who controls or administers the fund;
- (e) whether the fund is audited and, if so, by whom and when;
- (f) whether the fund's financial statements can be inspected by, or will be given to, franchisees;
- (g) the kinds of expense for which the fund may be used;
- (h) the fund's expenses for the last financial year, including the percentage spent on production, advertising, administration and other stated expenses;
- (i) whether the franchisor or its associates supply goods or services for which the fund pays and, if so, details of the goods or services;
- (j) whether the franchisor must spend part of the fund on marketing, advertising or promoting the franchisee's business.

FCC Sub-clause 17

17 Marketing and other cooperative funds

(1) If a franchise agreement provides that a franchisee must pay money to a marketing or other cooperative fund, the franchisor must:

(a) within 3 months after the end of the last financial year, prepare an annual financial statement of the fund's receipts and expenses for the last financial year, including the amount spent on production, advertising, administration, goods or services supplied by the franchisor or an associate of the franchisor and other stated expenses; and

(b) have the statement audited by a registered company auditor within 3 months after the end of the financial year to which it relates; and

(c) if the franchisee asks, in writing, for a copy of the statement — give a copy of the statement to the franchisee within 30 days after the request.

(2) However, a franchisor does not have to comply with paragraph (1) (b) for the financial year if 75% of the franchisor's franchisees in Australia, who contribute to the fund, agree.

(3) A franchisor is taken to have complied with paragraph 12.1 (h) of Annexure 1 if, to the extent to which the franchisor is aware of the details, the franchisor supplies the following information for the period before 1 July 1998 to the franchisee:

(a) the amounts of expenditure on production, advertising, administration and any other category of expenditure stated in the disclosure document for each marketing or other cooperative fund controlled or administered by or for the franchisor to which the franchisee may be required to contribute;

(b) the percentage that each amount disclosed in accordance with paragraph (a) constitutes of the total expenditure disclosed in accordance with that paragraph.

(4) If a franchise agreement provides that a franchisee must pay money to a marketing or other cooperative fund, the reasonable costs of administering and auditing the fund must be paid from the fund.

This financial disclosure does nothing to prevent the franchisor from exercising to its fullest extent the discretion accorded to it in the contract term. There is no franchisor obligation to balance the interests of franchisees against its own in making advertising decisions and expenditures, even though these expenditures are funded by franchisees. Disclosure required under Clause 17 allows franchisees to inform themselves about a franchisor's activities in this area, but the burden is still on franchisees to do this, and, if necessary, to prove that a franchisor's expenditures are not being made reasonably. This will be made more difficult by the fact that a franchisor has discretion or absolute discretion and often no obligation to spend the funds.

The 2006 Review of the Disclosure Provisions of the Franchising Code of Conduct made the following recommendation:

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the Code be subject to compulsory annual audit by a registered company auditor.⁵²⁹

The Government in response stated that it would require that the Code be amended to provide that franchisees are provided with a full account of these funds and with the auditor's reports.⁵³⁰ This measure fails to address the franchisor/franchisee conflicts of interest in the way the funds are spent in promotion, which is still left entirely to franchisor discretion.

Summary and measures to address imbalance of power and lack of certainty in franchisor promotions

A franchisor has discretion, often absolute discretion to spend or not to spend franchisee funds for promotions. Since their interests are not the same as a franchisor's, franchisees need some protections. Substantive requirements would be useful but, due to the relational nature of the contract and the need for discretion, these may not be possible. If a franchisor cannot be held to specific obligations over the long term, to ensure its legitimate interest in discretion in promotional decision-making, then procedures may help to ensure proper consideration of the interests of a franchisee.

Given the importance of a franchisor's obligation to maintain the brand, franchisees might want to negotiate performance or procedural standards to ensure that they can monitor and enforce the term. To enhance certainty a franchisee might want to ensure prudent administration of the fund that serves the interests of both franchisors and franchisees; potential measures could include a substantive provision outlining specific franchisor obligations or warranties regarding advertising. The question here

⁵²⁹ The *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007 Recommendation 6: Auditing of marketing and other co-operative funds.

⁵³⁰ See the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007 and the Australian Government *Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

is whether a franchisor will in fact offer any such assurances, or whether it will only be possible to secure from it some caveats, such as a detailed explanation of the scope of a franchisor's discretion in undertaking its own marketing efforts and how these may be in conflict with the interests of the individual franchisee or franchisees collectively.

The advertising and promotions function presents another instance where consultative processes could enhance certainty. Franchisee participation in promotions can help ensure that a franchisor is performing. The contract might include assurances of franchisee inclusion in decision-making processes and/or required involvement of the Franchisee Advisory Council (FAC). Such measures could ensure quality of franchisors efforts, and could also help limit a franchisor's liability in case of problems with promotions. Legal counsel for franchisors themselves suggest some franchisee participation (though never a veto power).⁵³¹

⁵³¹ E-Mail to listserv Sept 2005 from David E. Holmes, Holmes and Lofstrom, LLP, D.Holmes@HolmesLofstrom.com
<<http://mail.abanet.org/scripts/wa.exe?A2=ind0509&L=franchising&P=R21578&I=-3>> at 30 December 2005.

5.6 CONTRACT TERM: SUPPLY

Supply requirements allow a franchisor to control franchisees' use of sub-standard products and free-riding on the quality of product in other units, as well as to provide for approved suppliers, and to maintain levels of stock. In the name of uniformity and brand maintenance, a franchisor exercises control over supply and can impose changes unilaterally. A franchisee must follow a franchisor's requirements.

Supply requirements vary with the type of franchise business. Franchises that involve sales of products often involve supply and product-tying requirements where any variation by a franchisee is subject to franchisor approval.⁵³² A franchisor may be a supplier or one of several approved suppliers, and will negotiate supply and distribution contracts to which it may require franchisees to commit to certain levels of purchases, regardless of whether local conditions warrant such levels.⁵³³

Here again a franchisor's legitimate need to preserve uniformity creates risks to a franchisee. A franchisor can require a franchisee to supply from a franchisor, which sets prices and controls quality so that a franchisor's product purchase requirements can erode franchisee profit margins. Tying franchisees to vendors reduces franchisee flexibility in supply, threatens competition and can cause franchisees to have to pay higher prices, thus reducing franchisee profit margins. Thus, if franchisees must purchase products solely from a franchisor, or from suppliers designated by a franchisor, the determination of a franchisee's gross margin lies in the hands of a franchisor.⁵³⁴

Supply requirements also pose a risk where there may be secret rebates to franchisors. Kickbacks, promotional fees and commissions paid to franchisor reduce franchisee profit margins.⁵³⁵ A franchisor has discretion to require a franchisee to purchase from a supplier whose products are more expensive, but who pays a franchisor a

⁵³² Antony W. Dnes, 'A Case-Study Analysis of Franchise Contracts' (1993) 22 *Journal of Legal Studies* 367, 393.

⁵³³ <<http://www.tfsa.info/consider.htm> at 15 February 2005.

⁵³⁴ E-mail from David Newton, 10 Feb 2003. The particular concerns here involve quality, price or delivery time of goods.

⁵³⁵ *The Problems Franchisees Face* (2003) American Franchise Association <<http://www.franchisee.org/Buying%20a%20Franchise.htm#problem>> at 9 December 2006.

commission. Some franchise contracts expressly protect a franchisor's right to make deals with franchisee suppliers.

Table 5.6: Summary of Supply Terms in Contracts under Review

Franchise system	Supply
F1	Franchisee shall maintain in sufficient supply, and use and/or sell at all times, only such Products and Supplies as meet (franchisor) standards and specifications (Franchisee shall not deviate without franchisor's prior written consent) and as are expressly approved for use and/or sale in writing by franchisor. The Franchisee shall sell or offer for sale all types of Products and services specified by Franchisor
F2	franchisee only sells approved products, other suppliers as approved by franchisor
F3	According to franchisee's terms and conditions The Franchisee acknowledges that any goods supplied by the Franchisor to the Franchisee are supplied in accordance with the Franchisor's terms and conditions for supply of goods current at the time of supply
F4	Franchisee must only prepare, supply, deliver and sell only the full range of products. Franchisee must take all measures necessary to obtain appropriate authorization.
F5	Merchandise S. 65: You are liable for the cost of purchasing your merchandise. S. 66: You agree to: (a) remove at our request any merchandise which does not, in our opinion, meet our standards. (b) make available for sale from the premises at least the minimum product range that we determine should be stocked by our franchisees generally. (c) Have on hand at least the minimum stock levels deemed appropriate by us for a store of your size and turnover from time to time. (d) display and sell only authorised products. S.67: You must: display the merchandise for sale in accordance with our specifications from time to time. remove from display any damaged or soiled merchandise.
F6	Purchase only from Franchisor or approved suppliers. Franchisee must: purchase all quantities of the Approved Ingredients used for the preparation of Authorised Products sold or offered or advertised for sale in or from the Premises from Franchisor or its approved suppliers provided that in the event that at any time or from time to time franchisor or its approved suppliers are unable to supply the Franchisee (except where the Franchisee is in breach of this Deed or any of the payment and delivery terms and conditions) with such quantity or quantities or such flavour or flavours of the Approved Ingredients as the Franchisee may reasonably require, Franchisor may (in its absolute discretion but entirely without

	<p>being obliged to) substitute other Approved Ingredients for the period of the shortage or permit the Franchisee to acquire such quantity or quantities of the Approved Ingredients from any alternative supplier approved by Franchisor, but only to the extent to which and for the period during which Franchisor or its approved supplier, is unable to supply the Franchisee (and the Franchisee acknowledges that Franchisor has the right at anytime to discontinue, substitute, alter, change packaging, or add to the range of Approved Ingredients).</p> <ul style="list-style-type: none"> • (b) maintain in the Premises such minimum quantity or level of the Approved Ingredients as Franchisor may from time to time specify; purchase sufficient quantities of the Approved Ingredients to enable the Authorised Products to be prepared and sold or offered or advertised for sale in or from the Premises or stocked or stored in the Premises, to meet the demand for the Authorised Products; and purchase all quantities of the Approved Ingredients required for use in the Premises, from Franchisor or its approved suppliers
F7	<p>The Franchisee must purchase all of the Special Products and Approved Products ...only from Approved Suppliers on the written terms and conditions specified by those suppliers.</p> <p>If the Franchisee wishes to use a supplier of Special Products or Approved Products who is not an Approved Supplier, the Franchisee must obtain the Franchisor's written consent. This consent must not be unreasonably withheld if the Franchisee:</p> <ul style="list-style-type: none"> - gives the Franchisor written notice of the nature and quantity of the products or services that the Franchisee is seeking to purchase; the name and address of the proposed supplier; and the price per unit that will be charged by the proposed supplier for the product or service; delivers to the Franchisor a sample of the product or service that the proposed supplier will provide; provides a written statement from the proposed supplier of the period that those prices will be fixed; and the terms and conditions of supply; satisfies the Franchisor that the proposed supplier is able to maintain a continuity of supply of the product or service; and satisfies the Franchisor that the product or service meets the criteria set out in clause Franchisor's Response <p>If the Franchisor's approval is sought... the Franchisor must advise the Franchisee of its decision within a reasonable time.</p> <p>Franchisee must not offer, sell or supply any food or beverages that are not specified on the Menu, unless the Franchisee first obtains the Franchisor's written consent.</p>
F8	<p>Maintain Stock – The Licencee shall ensure that the Licenced Operation has sufficient Products and so arrange the Licencee's affairs to meet the specifications of the Licensor and market demand.</p> <p>3.46 Use Approved Products – The Licencee shall only stock Products and brands of Products approved and promoted by the Licensor and such Products purchased from the Licensor (but only to the extent that it is lawful to oblige the Licencee to do so without breaching the provisions and trade practices legislation relevant to the Territory of the Licenced Operation) if available from the Licensor. If such Products are not available, the Licencee shall purchase those Products from suppliers</p>

	approved of by the Licensor (“Approved Suppliers”).
F9	<p>(16) the Franchisee acknowledges that it is in the interests of the Franchisee, the Franchisor and all other franchisees of the Franchisor that the uniform standards of the Franchisor System be adhered to. Accordingly, the Franchisee agrees to sell, handle, dispense or otherwise deal in only those Products and perform only such services as may be associated with the Franchisor System and specified by the Franchisor from time to time. The Franchisee further agrees to purchase all Products to be sold, handled, dispensed or otherwise dealt in with respect to the operation of the Business only</p> <p>(a) from the Franchisor, or</p> <p>(b) from suppliers (who may include affiliates of the Franchisor) which the Franchisor has advised the Franchisee have been approved by; or</p> <p>(c) from suppliers nominated by the Franchisee that the Franchisor has advised the Franchisee satisfy the quality standards set by Franchisor.</p> <p>(17) whenever reasonably possible, to offer the Products for sale to the public at such prices as the Franchisor may reasonably suggest from time to time; provided it is agreed, the Franchisee is under no obligation to accept such suggested prices and the Franchisee will not suffer in its business relations with the Franchisor if it does not offer the Products at the suggested prices; however, prior to varying the suggested prices, the Franchisee agrees to consider the effect of such variance on its sales and its profits, and generally the detrimental effect, if any, to the sales and profits of other franchisees of the Franchisor, and to the Franchisor System;</p>
F10	No supply requirements – mobile service.
F10	Not stated.
F11	The franchisee must comply with the service standards set out in the Tool Kit. The franchisee must only provide Services approved by franchisor
F12	The Franchisee must participate in any business systems, techniques, initiatives, programmes, computer facilities and other facilities (“the facilities”) the Franchisor thinks necessary.
F13	you must purchase all the products from Franchisor or through Franchisor ; and if Franchisor or its suppliers are unable to supply all or part of an order for product within 14 days of the receipt by Franchisor of an order, you may acquire through Franchisor any outstanding items from on alternative supplier approved in writing by Franchisor (which approval shall not be unreasonably withheld); and to ensure those items are at least equal to the level of quality prescribed by Franchisor , suitable for the purpose for which they were intended, and also for any bar-coding purpose, you must supply and deliver to Franchisor a sample of each product purchased from the alternative supplier in (b) above. If Franchisor disapproves of the sample, you must not sell products represented by the sample
F14	<p>25. You must not:</p> <p>(a) sell any goods from the Business Premises other than those goods falling within the National Menu, without our prior written consent;</p> <p>(b) sell any goods from the Business Premises other than as a retailer - this means that you must not sell goods as a wholesaler or to any person which intends on selling the goods to consumers.</p>
F15	<p>Supplies of Product. The Franchisee agrees that:</p> <p>(a) the Franchisee shall stock use and sell only the Products in the</p>

	<p>Franchised Operation which have been specified by the Franchisor and are permitted by the Head-Lease. Under no circumstances shall the Franchisee stock, use or sell products other than the Products or those specified by the Franchisor and permitted by the Head-Lease. The Franchisee shall sell all Products specified from time to time by the Franchisor and that are permitted by the Head-Lease;</p> <p>(b) the Franchisor shall source approved recommended suppliers in respect of all Products and supplies used in connection with the Franchise from such appropriate suppliers that meet the standards for quality, reliability and product control as specified by the Franchisor from time to time and as shall be approved by the Franchisor. The Franchisee shall acquire all Products and supplies only from suppliers who have been approved by the Franchisor, as meeting its standards for quality, reliability and product control. Should a Franchisee wish to acquire products or supplies from a non-approved supplier it must submit all necessary details and samples to the Franchisor or the Franchisor for approval;</p> <p>(c) the Franchisor shall be entitled to negotiate and receive a fee from suppliers used by Franchisees;</p> <p>(d) it shall use only Franchisor bags, paper goods and packaging of the type approved by the Franchisor and bearing the Names and Marks or insignia or labels approved by the Franchisor. The Franchisor shall authorise and permit manufacturers of bags paper goods and packaging of the type approved by the Franchisor to imprint the approved labels, Names and Marks or insignia on them and provided further that the imprinted bags, paper goods and packaging shall be used exclusively by the Franchisee in connection with the operation and conduct of the Franchised Operation and for no other purpose;</p> <p>(e) Products will be supplied by companies associated with the Franchisor at prices that reflect the cost of manufacture plus a reasonable mark up but otherwise at wholesale cost plus a maximum gross profit margin of 50%;</p> <p>(f) The Franchisor, in its absolute discretion, will determine by notice in writing to the Franchisee on a bi-annual basis, the type, quality, range and value of Products to be maintained by way of stock levels by the Franchisee in its operation of the Business during the Term.</p>
F16	<p>No specific supply requirements – as this is a mobile service. However some standards apply –</p> <p>8.6 Approved products and services</p> <p>The Master Franchisee must use its best endeavours to ensure that Sub-Franchisees only use equipment, supplies, products and services which conform to the Franchisor’ standards and specifications and as set out in the Franchise Agreement and Operations/Marketing Manual. Any list of approved suppliers provided to the Master Franchisee will refer to suppliers whose supplies, products and services conform to the Franchisor’s quality standards and whose prices are competitive.</p>
F17	<p>During the franchise term, you must make sure that your business: offers for sale and sells all approved foods and beverages as stated on the Franchisor foods and beverage menus applicable to your business or that are otherwise authorised by us; and provides dine-in, takeaway and customer services in line with the system standards or as reasonably required by us. During the franchise term. you must not offer for sale or sell from the store, foods, beverages, goods or services that have not been approved by us for sale</p>

	<p>from your business.</p> <p>During the franchise term, you must make sure that in connection with your business you use: all ingredients, flavourings, garnishments. doughs, spices, foods or beverages, cooking materials, containers, packaging materials, paper and plastic goods, equipment, menus, forms, cleaning and sanitation materials and other supplies that are reasonably approved by us or that comply with the system standards; boxes, containers, plastic and paper goods printed with the trade names, trade marks or copyright works that form part of the system standards or that we reasonably require.</p> <p>You and your associates agree that: it is integral to the system that only approved foods and beverages from approved Franchisor food and beverage menus applicable to your business be sold or supplied from your business; and some foods, beverages and/or services supplied from your business have become linked to or indistinguishable from the system, the image, the trade names or trade marks.</p>
F18	No specific supply requirements.
F19	<p>Products</p> <p>During the Term the Member must:</p> <p>(1) offer for sale at a price not exceeding the price specified by the Company in any promotion to customers or the public, any products which are the subject of such promotions undertaken by or on behalf of the Company for the duration of the promotional period, provided that stocks of such products are readily available for purchase from the Company by the member prior to the commencement of, and for the duration of, any such promotion...</p>

Discussion of results

Most contracts in the sample restrict a franchisee's liberty to supply through the conditions, specifications and/or standards of supply set by a franchisor. Systems F1 through and including F9 as well as F13, F15 and F17 all require a franchisee to supply only what meets franchisor's standards and specifications, terms and conditions, or similar language.

Some supply clauses refer to franchisor's specifications with respect to quantity (F5 and F6). F2, F6, F7, F9 and F13 also requires that franchisees can only supply from the franchisor or approved suppliers. Some systems (F2, F5, and F17) stipulate that a franchisee can only source approved products rather than from approved suppliers. F8 stipulates both approved products and approved suppliers.

F6 allows a franchisor to set quantities as well as to require its franchisees to purchase from the franchisor or approved suppliers. Thus, the franchisor can say that its

franchisee can only buy from the franchisor, in the quantities the franchisor dictates, regardless of the franchisee's requirements.⁵³⁶

F15 specifically authorizes payments to a franchisor by suppliers of a franchisee, 'the Franchisor shall be entitled to negotiate and receive a fee from suppliers used by Franchisees'.

There appears to be a difference in the importance placed upon supply across different types of franchise systems. In the case of restaurants there was greater attention in the contract to the issue of supply (F1, F4, F6, and F7). In the case of retail a franchisor may be less concerned about its role as supplier. In coaching/training, manuals are a revenue source for a franchisor, but not a principal source. In services supply appears less important, but there will still be standards and requirements (F10, F11, F16 and F18).

⁵³⁶ This is what happened in the *Simply No-Knead* case. See *ACCC v Simply No-Knead (Franchising) Pty Ltd* [2000] Australian Competition & Consumer Commission v *Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365.

Direct intervention in supply

Supply is regulated by the Code Disclosure Items 9 and 10. Currently, supply requirements as a relationship issue between franchisor and franchisee are regulated only through disclosure.⁵³⁷

Disclosure Item 9 Supply of goods or services to a franchisee

9.1 For the franchisor's requirements for supply of goods or services to a franchisee — details of:

- (a) any requirement for the franchisee to maintain a level of inventory or acquire an amount of goods or services; and
- (b) restrictions on acquisition of goods or services by the franchisee from other sources; and
- (c) ownership by the franchisor or an associate of the franchisor of an interest in any supplier from which the franchisee may be required to acquire goods or services; and
- (d) the obligation of the franchisee to accept goods or services from the franchisor, or from an associate of the franchisor; and
- (e) the franchisor's obligation to supply goods or services to the franchisee; and
- (f) whether the franchisee will be offered the right to be supplied with the whole range of the goods or services of the franchise; and
- (g) conditions under which the franchisee can return goods, and to whom; and
- (h) conditions under which the franchisee can obtain a refund for services provided by the franchisor, and from whom; and
- (i) whether the franchisor may change the range of goods or services, and if so, to what extent; and
- (j) whether the franchisor, or an associate of the franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, and whether any rebate or financial benefit is shared, directly or indirectly, with franchisees.

Note Before a requirement is made under paragraph (b) or (c), the franchisor may notify, or seek authorisation from, the Australian Competition and Consumer Commission (see Act, Part VII).

⁵³⁷ This may be in part due to the role of competition law with respect to this aspect of the contract. Supply is dealt with under the competition law provisions of the TPA to regulate the impact of franchise systems' activities on the market. The drafters of regulation may have felt that supply was not a relationship issue, but rather an issue that should be dealt with, if necessary, through competition law.

Disclosure Item 10: Supply of Goods or Services by a Franchisee

Details of:

- (a) restrictions on the goods or services that a franchisee may supply; and
- (b) restrictions on the persons to whom a franchisee may supply goods or services; and
- (c) whether a franchisee must supply the whole range of the goods or services of the franchise.

The 2006 Review of the Disclosure Provisions of the Franchising Code of Conduct recommended,

‘Item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.’⁵³⁸

The government agreed to this extension of disclosure to provide ‘greater transparency in the relationships between the participants in franchising.’⁵³⁹ This change is good news for franchisees. Supply is one of many instances where control in the hands of a quality franchisor benefits both the system and its franchisees, while control by an opportunistic franchisor can create serious problems for franchisees.

Summary and measures to address imbalance of power and lack of certainty in supply

An imbalance of power manifests itself again in this term in the form of control by a franchisor over franchisee’s supply. Power, control and whatever certainty can be had reside with the franchisor. This imbalance is ensured by the contract that allows little or no latitude for a franchisee to deviate from franchisor requirements.

⁵³⁸ Item 5 of the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007.

⁵³⁹ *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

The proposed change to the Code may help to curb franchisor abuse with respect to rebates and approved suppliers, but it does not cure these problems entirely, nor does it address others, such as a franchisor's ability to dictate franchisee levels of stock. Other measures to enhance certainty and improve balance of power include processes for collective participation, in particular measures that allow franchisees to play a role in negotiating supply such as procedures for approval of new brands or suppliers to ensure franchisor's reasonable control over price and quality.⁵⁴⁰ Collective participation could also involve franchisee-operated buying cooperative for larger systems, along with a franchise contract that authorizes franchisee to shop from among several franchisor approved suppliers. Here, too, protection of franchisees against uncertainty means that procedures for franchisor approval should be clearly specified.⁵⁴¹ A franchisor does have a legitimate interest in uniformity, but a franchisor's power must be balanced against the interests of its franchisees, for example in their ability to make a reasonable profit.

⁵⁴⁰ American Bar Association Forum on Franchising, Rupert M. Barkoff (Ed), Andrew C. Selden (Ed), *The Fundamentals of Franchising* (1997) 58.

⁵⁴¹ Dairy Queen franchisees in the US formed a purchasing cooperative and recruited new suppliers, but the suppliers still needed approval from the franchisor that franchisees say was difficult to obtain. See Alexandra Friedman, 'Ten things your franchiser won't tell you', partial reprint from *Smart Money Magazine*. <<http://www.zarcolaw.com/CM/News/news46.asp>> at 30 December 2005.

5.7 CONTRACT TERM: MINIMUM PERFORMANCE AND REPORTING REQUIREMENTS

Minimum performance clauses and reporting requirements are used by a franchisor to address franchisee free-riding on the performance of others, inaccurate reporting by franchisees, and the lack of available high-quality franchisees. Minimum performance clauses help curb franchisee free-riding by ensuring the performance levels of each individual franchisee. A franchisor takes measures to ensure franchisee performance through accounting procedures; minimum performance clauses; specific benchmarks; reservation of right of inspection,⁵⁴² and restrictive covenants that may require a franchisee to devote its effort exclusively to the operation of the franchise or set minimum hours or impose restrictions on passive ownership. The costs of these measures are generally passed on to a franchisee

A franchisor is vulnerable to a franchisee's information advantage about the operation of the local franchise unit. A franchisee may be tempted not to provide a franchisor with accurate accounts, as this information affects the amount of royalty a franchisee must pay, and the attainment of performance targets. Here again, a franchisor and a franchisee's interests diverge. A franchisor will focus on volume as the most important indicator of the franchise unit performance, while a franchisee may be more concerned with profit and may be tempted to inflate costs (or a franchisee may for some reason lack incentive to control costs).⁵⁴³ To counter its risk due to asymmetric knowledge, a franchisor includes contract provisions to help ensure its right to information through reporting requirements, periodic reporting/reviews, verification methods, and verification procedures. Franchisor access to a franchisee's business premises and computer systems may also be expressly guaranteed in the contract. Some contracts may allow a franchisor access to all franchisee computers and business records, with no qualification that they be related to the franchise operation. Such terms raise concerns over invasion of privacy because they provide an unnecessarily broad licence for a franchisor to intrude on a franchisee's operation.

⁵⁴² American Bar Association Forum on Franchising, Rupert M. Barkoff and Andrew C. Selden (eds), *Fundamentals of Franchising* (1997) 61-62.

⁵⁴³ Antony W. Dnes, 'A Case-Study Analysis of Franchise Contracts' (1993) 22 *Journal of Legal Studies* 367.

Franchisors also rely on these clauses to mitigate problems stemming from poor quality of franchisees where there is an inadequate supply of qualified franchisees. A franchisor shifts the risk that a franchisee will fail to each franchisee through its ability to terminate if a franchisee does not meet the performance standards. For example, if there is an exclusive grant (the territory is usually limited to the premises), minimum performance requirements facilitate franchisor’s taking back the franchise due to under-performance and so help ensure that a franchisor can maximize revenues from the territory. Such provisions should be considered carefully by the prospective franchisee, as they may permit a franchisor to terminate the franchise on the basis of unilaterally imposed performance requirements that are vague or unfair.

Table 5.7: Summary of Minimum Performance and Reporting Requirements in Contracts under Review

Franchise system	FRANCHISEE MINIMUM PERFORMANCE and REPORTING REQUIREMENTS
F1	The Franchisee covenants that, during the term of this Agreement, the Franchisee or its designated manager, shall devote full time, energy, and best efforts to the management and operation of the Store.
F2	Franchisee must during the Term conduct the Business in a proper and efficient manner... The Franchisee must devote all of its reasonable efforts towards the operation and growth of the Business and must not engage in any other business without the Franchisor's prior written consent. The Franchisor’s consent will not be unreasonably withheld
F3	Franchisee must operate according to OM and other directives of franchisee Report weekly, quarterly and annually, Submit tax returns, Franchisee pays all franchisee costs in connection with agreement except 27.6 costs of dispute. The Franchisee must prepare and implement one year firm and three year indicative <i>business plan</i> for the conduct of the business including financial and non-financial key performance indicators, in a format approved by the Franchisor.
F4	Franchisee must at all times, faithfully, honestly and diligently perform its obligations, and must continuously devote its full time, attention and best efforts to the operation of the Franchise. Franchisee must nominate a senior officer as the nominated manager who is responsible for compliance with agreement and supervision. Franchisee and manager must exercise best efforts and devote at min. 20 hours per week to: (A) Supervising operation (B) promoting and maximising the sales (C) Obtaining and maintaining goodwill (D) Safeguarding the interests of the Franchisee.

	<p>Franchisee must at all times ensure that the premises and all equipment meet the both the operation manual's standard as well as appropriate standards of design, function, performance and serviceability.</p> <p>Franchisee must properly and accurately record its gross sales and report to Franchisee.</p>
F5	<p>You must exercise your best efforts at all times to achieve the highest possible level of sales of the authorised products from the premises. We may meet with you from time to time to discuss your sales performance. However, you shall be responsible for achieving the sales performance at all times and we have no responsibility in this regard.</p> <p>You must ensure that your gross sales in any 12 month period do not fall below the minimum sales level set out in item 18 of the Schedule.</p> <p>If your annual gross sales fall below the minimum sales level in any 12 month period, the we may notify you of the fact in writing and may in our absolute discretion require you to undertake any or all of the following steps at your cost:</p> <ul style="list-style-type: none"> (a) meet with our representative to review your sales performance, (b) attend such meetings or complete such further training sessions as required by us, (c) make such changes to the franchise business as we may reasonably require <p>If, despite attending to the requirements of clause 0, your annual gross sales do not increase to a level above the minimum sales level then we may notify you of the fact in writing and in our absolute discretion either require that further training and changes are required as per clause 0 above, or if there is no valid external commercial reason for the failure to achieve the minimum sales level, may elect to terminate the Agreement by written notice.</p> <p>You must give the following information to us in the form required by us:</p> <ul style="list-style-type: none"> (a) within two days of the end of each trading period, a statement of your daily gross sales for the previous trading period, less any merchant fees paid in respect of those sales. (b) within seven days of the end of each trading period, a list detailing the daily quantity, sales value and gross profit of each model sold. (c) by the end of each trading period a statement of your cost of sales for the previous trading period and stock on hand at the end of the previous trading period. (d) by 30 November of each year detailed statements of financial performance and financial position prepared by your accountant and verified by you for the previous financial year. (e) by 30 September of each year the information required by us to complete our annual benchmark study including preliminary statements of financial performance and financial position. (f) by the 7th day after request, any other financial or non-financial information required by us concerning the franchise business including copies of returns made to government bodies
F6	<p>The Franchisee will deliver or transmit (by electronic means) to FRANCHISOR on the due date all reports as set out in the Confidential Operations Manual or as stipulated from time to time in writing by Franchisor.</p>
F7	<p>Achieve Minimum Performance Criteria (F7)</p>

	<p>The Franchisee must achieve the Minimum Performance Criteria during each Assessment Period.</p> <p>Failure to achieve Minimum Performance Criteria If the Franchisee fails to achieve the Minimum Performance Criteria in any Assessment Period the Franchisee and Manager must attend a meeting held by the Franchisor, at the Franchisee’s Cost, to discuss the performance of the Business.</p> <p>Training Attendance If the Franchisor considers that the Franchisee has failed to achieve the Minimum Performance Criteria for reasons within the control of the Franchisee, the Franchisor may require the Franchisee and/or the Manager and/or the Franchisee’s employees, provided that, in the case of the Franchisee’s employees, the training is to be held in the State in which the Premises is located, to undertake the Franchisor’s initial training program, at the Franchisee’s cost.</p> <p>Further Failure by Franchisee If the Franchisee fails to:</p> <ul style="list-style-type: none"> - attend a meeting with the Franchisor in accordance with clause 0; or - attend and complete or procure that its Manager and/or employees attend and complete to the satisfaction of the Franchisor an initial training program required by the Franchisor under clause 0; or - meet the Minimum Performance Criteria for an Assessment Period within 6 months of: <ul style="list-style-type: none"> - attending a meeting with the Franchisor in accordance with clause 0; or - the Franchisee, the Manager and/or the Franchisee’s employees completing the Franchisor’s initial training program, as required under clause 0, - the Franchisee must, within 6 months of the date upon which the Franchisor notifies the Franchisee that it has failed to meet one or more of its obligations under this clause 0, sell the Business in accordance with the procedure set out in clause
F8	<p>3 Licencee’s duties</p> <p>3.3 Promotion the Operation – The Licencee will actively and diligently promote the Licenced Operation and exercise the Licencee’s best endeavours in the conduct of the Licenced Operation to promote the mutual business interests of the Licensor and the Licencee and cause to be provided at the Location all such facilities and Services and Products as the Licensor shall require and shall employ sufficient, qualified and trained staff to effectively conduct the Licenced Operation.</p> <p>3.54 Observe and Maintain Standards – The Licencee shall observe and maintain standards in the conduct of the Licenced Operation at least equal to those prescribed from time to time by the Licensor and comply with the regulations, procedures and standards set down by the Licensor in any Manuals issued by the Licensor to the Licencee during the Term.</p> <p>3.34 Keep Accurate Records – The Licencee shall keep true and correct records, accounts, books and data (the “Records”) on the premises of the Licenced Operation which shall accurately reflect all particulars relating to the Licenced Operation and conform to the requirements prescribed by the</p>

	<p>Licensor the Licencee shall submit to the Licensor upon request from the Licensor the Records together with such other information and reports concerning the Licensor Operation in such form as the Licensor shall from time to time prescribed or otherwise require and Licencee warrants the truth accuracy and completeness of any such Record information or reports provided to the Licensor. The Licencee shall preserve and keep available all Records for a period of not less than seven (7) years.</p>
F9	<p>7. DUTIES AND OBLIGATIONS OF THE FRANCHISEE</p> <p>7.1 Business Obligations</p> <p>The Franchisee hereby covenants and agrees at its sole expense, to do and/or perform each of the following:</p> <p>(1) to operate the Business at the Premises using the Franchisor System and not to engage in any other type of business at the Premises; to carry on the Business at all times in an up-to-date and reputable manner and to devote its full time attention and effort in order to diligently and efficiently establish, develop and promote the Business; and to operate the Business in strict compliance with the standards, policies and rules of the Franchisor including without limiting the generality of the foregoing...</p> <p>5 ACCOUNTING RECORDS. REPORTS AUDITS</p> <p>5.1 Covenant to Keep Records and Reports</p> <p>The Franchisee covenants and agrees to maintain such books and records and to submit such statements and reports to the Franchisor as are specified in this agreement or as otherwise may be required by the Franchisor from time to time. Such statements and reports shall be in such form and style and shall contain such details and breakdown as the Franchisor may in its discretion determine. Without limiting the generality of the foregoing, if at any time during the currency of this agreement the Franchisor institutes any computerised accounting, reporting, inventory control, book keeping or other similar type program or system, the Franchisee at its expense, agrees to utilise such program or system, and to maintain such of its books and records and prepare such of its statements and reports in accordance with such program or system.</p> <p>5.2 Reports to be Submitted</p> <p>The Franchisee agrees to submit to the Franchisor:</p> <p>(1) by the 10th day of each month of the Term, a monthly report of Gross Revenue for the preceding month, and such report shall specifically include if required by the Franchisor, the amount of the daily Gross Revenue;</p> <p>(2) within 60 days of the end of each fiscal year of the Franchisee, a copy of the Franchisee's financial statements (certified by the Franchisee as being true and correct and including without limitation a balance sheet and a statement of profit and loss) in respect of the Business as at the end of each year;</p> <p>(3) a copy of all financial and other reports and statements submitted by the Franchisee under the provisions of the Lease and/or the Sublease; and</p> <p>(4) upon the written request of the Franchisor, copies of all income, and sales tax returns submitted by the Franchisee to the appropriate authorities.</p> <p>5.3 Records to be Kept for 3 Years</p>

F10	<p>Obligations of Franchisee To Operate</p> <p>The Franchisee agrees to devote their sole attention and endeavours to this Franchise Business.</p> <p>Customer complaint handling</p> <p>7.39 The Franchisee must immediately inform the Regional Franchisor of any complaint made by a customer with respect to the behaviour of the Franchisee, it's employees and agents, and allow the Regional Franchisor or its representative to investigate the complaint and take such remedial action as is deemed necessary by the Regional Franchisor. The Franchisee shall be responsible for and pay the Regional Franchisor all costs incurred by the Regional Franchisor in remedying the complaint.</p> <p>Obligation to keep records and provide reports</p> <p>7.40 The Franchisee must keep and maintain records, accounts, books and data which accurately reflect all particulars relating the Franchise Business ("records"). Such records must be prepared in accordance with a recognised accounting standard and must be preserved for a minimum period of seven (7) years.</p> <p>Obligation to provide reports</p> <p>7.41 The Franchisee must submit to the Regional Franchisor such information and reports concerning the Franchised Business as the Regional Franchisor reasonably requires including but not limited to the Franchisee's work diary and invoice and receipt books.</p> <p>Inspection of reports</p> <p>7.42 The records and reports referred to in Clause 7.41 must be available for the Regional Franchisor and its representatives to examine, copy and audit ("an inspection"). Any examination, copying or audit of such records may be carried out at all reasonable times without notice to the Franchisee.</p> <p>7.43 If an inspection pursuant to Clause 7.42 above reveals a deficiency in payment of Monthly Franchisee Fees to the Regional Franchisor, the Franchisee must immediately pay to the Regional Franchisor the amount of the deficiency in addition to interest calculated in accordance with Clause 14.9.</p> <p>7.44 If the inspection is necessitated by the Franchisee's failure to comply with this Agreement the cost of the inspection (including travel, accommodation, food, wages and professional costs incurred by the Regional Franchisor) must be paid by the Franchisee.</p> <p>7.45 The Regional Franchisor's rights pursuant to this clause are in addition to its other rights and remedies available to it in the event of a default by the Franchisee.</p>
F10	<p>Devote sole attention</p> <p>The Franchisee agrees to devote their sole attention and endeavors to this Franchise Business, except with written permission from the Franchisor.</p> <p>Inspections</p>

	<p>The Franchisee must, upon receipt of reasonable notice, permit the Franchisor to inspect the equipment and materials used in the Business, including diary and workbooks.</p>
<p>F11</p>	<p>Minimum performance standards are stipulated via the Schedule, in addition to various other minimum requirements noted throughout the Franchise Agreement.</p> <p>Schedule Item 7 Minimum Performance Standard: The franchisee must use its best endeavors to enter into consultancy agreements to provide Support to at least 2 clients per month.</p> <p>15.1 Participation – In consideration of payment of the Training Fee, Franchisor will provide the franchisee with initial training. Before beginning to operate the Business, the franchisee must participate in a four (4) day initial training program on conducting the Business. The franchisee must also participate in any other training Franchisor reasonably requires during the Term to ensure the efficient conduct of the Business. The initial training will be at the cost of Franchisor. The franchisee must complete all training programs to the reasonable satisfaction of Franchisor.</p> <p>15.2 Attain skills – The franchisee must at all times during the Term attain and display the skills which in Franchisor’ reasonable opinion are necessary to conduct the Business successfully.</p> <p>23.1 General obligations of franchisee – The franchisee must at its own expense: ... (b) Standard – Meet the Minimum Performance Standard Throughout the Term; (c) Promote Business – Promote and make every effort to increase the Business in the Territory;</p> <p>32 Secret Commissions The franchisee acknowledges that it is imperative to the goodwill of Franchisor’ Business and the Business that the franchisee does not accept any unusual or additional payment or gift from a Customer. The franchisee also must not accept a secret commission or payment in connection with the Business.</p> <p>Reporting requirements as follows. 18 Franchisee’s records and Audit 18.1 Keep Records – the franchisee must keep full and accurate books of account and records relating to the Business. All books and account records must be kept for at least seven (7) years after the end of the relevant financial year. 18.2 Reports – The franchisee must provide Franchisor with reports at the times and in the manner as set out in the Tool Kit. 18.3 Profit and Loss Statement – The franchisee must provide Franchisor with a copy of its Profit and Loss Statement and Balance Sheet for the</p>

	<p>Business for each financial year ended 30 June in each year by 30 September in each year during the Term.</p> <p>18.4 Franchisee’s records and audit – Franchisor has the right at any time, without notice to the franchisee, during the Term and for twelve (12) months after the Term by itself or through its authorised representatives to inspect and audit the books or account and documents of the franchisee relating to the Business. The inspection may be done at the location where the books and documents are usually kept. Franchisor may nominate an auditor to carry out the examination.</p> <p>18.6 Payment of understatement – If the audit, or the inspection as the case may be, discloses an understatement of any amount due to be paid by the franchisee to Franchisor, then the franchisee must pay the amount within two (2) weeks of receipt of the report.</p> <p>18.7 Report is binding – The auditor’s report will be final and binding on all parties.</p> <p>18.8 Inspection – The franchisee will permit Franchisor, its agents or representatives to inspect its books and records at any time in relation to Services provided to any specific Customer.</p>
F12	<p>Complete Attention</p> <p>8.2.1 The Franchisee or the Nominated Operator must directly supervise the Business on a daily basis, other than for absences in the normal course or such other absences approved in writing by the Franchisor.</p> <p>8.2.2 The Franchisee must make reasonable provision to maintain the Business during the Franchisee’s and Nominated Operator’s absences and vacations as described above in consultation with the Franchisor.</p> <p>8.4 Meetings</p> <p>8.4.1 The Franchisee or the Nominated Operator must use their best endeavours to attend all meetings called by the Franchisor.</p> <p>8.10 Operating Standards</p> <p>8.10.1 The Franchisee acknowledges and agrees that in order to achieve the highest level of service to customers of the Business, the Franchisee must conform to the standard of operation required by the Franchisor.</p> <p>8.21 Reports</p> <p>8.21.1 The Franchisee must provide to the Franchisor a monthly report for the business activities of the Business in the previous month, in such form and containing such information as the Franchisor requires.</p> <p>8.21.2 The Franchisee must provide the monthly report within seven (7) Business Days after the end of each month.</p> <p>8.21.3 Upon giving 30 days notice to the Franchisee, the Franchisor may alter the frequency, timing and method of reports under this clause. If an adequate computing system is in place, the Franchisor may require any report under this clause within 24 hours after the end of the relevant period.</p> <p>8.21.4 Within 150 days after each 30 June of the Term, if required by the Franchisor, the Franchisee must provide to the Franchisor financial statements for the Business for the financial year ending on that 30 June (including a profit and loss statement and balance sheet), prepared by a certified practising accountant in a form approved by the Franchisor.</p> <p>8.21.5 The Franchisor may use any information obtained from the Franchisee as it sees fit, but subject to any legislative obligations upon the Franchisor.</p>

	<p>8.21.6 The Franchisee will comply with any requirements of the Franchisor in relation to the provision of client information from the Franchisee to the Franchisor.</p> <p>8.22 Co-operation</p> <p>8.22.1 The Franchisee must provide whatever co-operation and assistance the Franchisor requires to enable the Franchisor to determine that the Franchisee is discharging its obligations under the Law.</p>
F13	<p>Franchisee must provide Financial Information incl. an audited sales certificate, P and L and Balance Sheet to Franchisee.</p> <p>Franchisee must keep and accurately maintain books of Account and Financial Records.</p> <p>...Promote Business by—Franchisee must employ sufficient competent staff.- working the required rate of business hours</p> <p>Standard of Conduct--Franchisee must observe standard of conduct as imposed by Franchisor from time to time.</p> <p>Franchisee must</p> <p>Repaint or Redecorate which Franchisor requires.</p> <p>Clean and Repair Premises to standard required by Franchisor.</p> <p>Keep Books of Account and Financial Records.</p> <p>Keep Sales Records</p> <p>Achieve Gross Sales Volume as specified by Franchisor.</p>
F14	<p>Subject to the requirements of the Lease or any relevant statute by-law or regulation, you must keep the Business Premises open for business at such hours as are necessary to successively conduct the Franchisor Business and not less than the minimum hours directed by us.</p> <p>Reporting obligations</p> <p>Each Friday you must forward to us weekly takings analysis in the form required by us. This should be forwarded with your royalty and advertising contribution payment.</p> <p>By the 10th day of each month, you must forward to us a monthly profit and loss statement for the previous month in the form required by us.</p> <p>By 31 December each year, you must, if requested by us, forward to us your annual financial statements (profit and loss statement and balance sheet for the year ending the preceding 30 June) prepared by your accountant. It is your responsibility to ensure that your accountant is able to complete these financial statements prior to 31 December each year.</p> <p>The financial information provided to us by you under this Agreement will become part of our business records and we shall be entitled to pass on this information to other interested parties such as lending institutions and other prospective franchisees at our discretion.</p>
F15	<p>6.8 Standard of conduct for Franchised Operation. The Franchisee shall comply with such standards in the conduct of the Franchised Operation (including with respect to the Premises) as may be prescribed from time to time in the Franchisee's Confidential Operation Manual or otherwise specified by the Franchisor in writing and in particular the Franchisee will comply with any instruction issued by the Franchisor and any amendments from time to time by</p>

	<p>the Franchisor.</p> <p>12.11 Complete Attention. The Franchised Operation shall at all times be under the direct supervision of the Franchisee, and, where the Franchisee is a company or partnership, the Nominated Operator. Except for short temporary absences and reasonable vacations from time to time, in which case the Business shall always be under the direct supervision of a fully trained employee-manager approved by the Franchisor, the Nominated Operator will devote his/her full-time attention to the Business.</p> <p>6.21 Books of Account. The Franchisee shall:</p> <p>(a) at all times keep and maintain a proper set of books of account together with all supporting documentation specified in the Manual including computer, cash register and support information in respect of the Franchised Operation and shall comply with such regulations and requirements in relation to such accounts as are by legislation or regulation required;</p> <p>(e) without limiting the generality of the foregoing the Franchisee shall during the continuance of this Agreement submit to the Franchisor a trading, profit and loss statement and balance sheet for the Franchised Operation in such form and content as determined by the Franchisor in writing from time to time for each half year terminating on the 30th June and 31st December during the Term. Such accounts are to be prepared and submitted to the Franchisor no later than ninety (90) days after the completion of each such half year;</p> <p>(f) supply to the Franchisor within three (3) days after each Accounting Week the Gross Sales figures for the Franchised Operation for that Accounting Week in writing together with the Additional Reports;</p> <p>(g) supply to the Franchisor the trading data described in Section 4 of the Franchisee's Confidential Operations Manual seven (7) days after the end of each calendar month for the purpose of receiving from the Franchisor monthly trading accounts and essential key profit performance indicators for the Business.</p>
F16	<p>No specific minimum performance standards stipulated. However, some involvement is required on the part of the Franchisee –</p> <p>8.7 Active promotion of business The Master Franchisee must at all times actively and diligently develop and promote the Franchisor' Franchise in the Master Franchise Area specified in Schedule 5.</p> <p>8.9 Performance review The Master Franchisee must conduct an on-site performance review of each Sub-Franchisee and Franchise area not less than once every six months of operation. The review must be conducted according to the Franchisor's appraisal format and shall be undertaken by the Master Franchisee with diligence.</p> <p>Reporting requirements</p> <p>11.7 Financial Statements Within three (3) months after the end of each financial year the Franchisor must:</p> <p>(a) prepare a financial statement of the Joint Advertising Funds' receipts and expenses; and</p> <p>(b) have the statement audited by a registered Company auditor; and</p>

	<p>(c) upon request, give a copy of the statement to the Master Franchisee within thirty (3) days after the request. Provided however that if 75% of the Master Franchisees who contribute to the Joint Advertising Fund agree, the Franchisor does not have to comply with 11.7(b)</p> <p>12.1 Maintenance of records The Master Franchisee must keep accurate and separate records, accounts, books and data in accordance with good accountancy practice in the Master Franchise Area and which accurately reflect all particulars relating to the Business. They must be preserved for at least seven years or in accordance with the statutory requirements relevant to the Master Franchise Area.</p> <p>12.2 Reports to be given to the Franchisor The Master Franchisee must, within ten (10) days after the end of each calendar month, submit to the Franchisor such information and reports concerning the Sub-Franchisees, the business or the operation of an Franchise area as the Franchisor reasonably requires, in the form the Franchisor specifies, including but not limited to:</p> <ul style="list-style-type: none"> (i) the name, address and contact telephone number of each Sub-Franchisee; (ii) a monthly report from each Sub-Franchisee in the format set out in the Master Franchise manual; (iii) a Franchise report (to be provided by the Franchisor for the Master Franchisee to complete) for the preceding month signed by the specified person; (iv) a monthly unaudited profit and loss statement for the Master Franchisee for the preceding calendar month; (v) within one hundred and twenty (120) days of the accounting reference date of the Master Franchisee, a balance sheet and profit and loss statement of the Master Franchise for the preceding financial year. If the Franchisor has reasonable grounds for believing such financial statements may reveal a discrepancy, the Franchisor can request the Balance Sheet and Profit and Loss Statement be in an audited form in accordance with generally accepted accounting principles in the Master Franchise Area; (vi) within one hundred and twenty days (120) days of the accounting reference date of each Sub-Franchisee if so request and received by the Master Franchisee, a balance sheet and profit and loss statement of each Sub-Franchisee for the Sub-Franchisee's preceding financial year, certified correct by a Certified Practising Accountant and the Sub-Franchisee; (vii) such other reports as the Franchisor designates from time to time.
F17	<p>ART 10 YOUR OBLIGATIONS 10.2 Pre-conditions to start of business You must not start your business without our consent until:</p>

- you and your associates have signed all the transaction documents that we require; the development works are finished to the system standards we require;
- you have enough stock to start your business;
- you have enough qualified staff to start your business;
- you have all the consents, permits and licences required by law to start your business; you have installed and displayed all Franchisor signage we require.

10.3 Your obligations

During the franchise term, you must in connection with your business:

- act in good faith and honestly with us;
- honestly and in good faith properly account for your turnover;
- keep your business open for trading during the core trading hours of the building or centre in which the store is located or as we or the lessors of the store reasonably state;
- have at least one qualified manager working in the store during all core trading hours;
- have one of your directors at the store during core trading hours for direct in store supervision of your business for at least 20 hours a week unless we have waived in writing this requirement in the case of a Franchisor store managed by us or an approved manager;
- supply all foods and beverages required by us from the then current Franchisor food and beverage menu approved for your business;
- adopt, introduce and serve any new foods or beverages we may require as soon as possible after we introduce any new food or beverage item to be served as part of the Franchisor menu;
- sell only foods and beverages we have approved but ensure that you do not breach the permitted use clause under your store premises agreement;
- make sure that all chef choices of food or beverages are appropriate and meet with our approval;
- except for pre-prepared or pre-cooked foods or beverages, make and prepare fresh in the Franchisor kitchens any foods or beverages that form part of the Franchisor approved food and beverage menus that we require to be prepared in the store for sale from your business and make sure that food and beverages are generally as fresh as possible;
- follow the food and beverage recipes and menus that we reasonably state;
- observe all reasonable recommendations we make as to the way food and beverages are to be made, prepared, packed, presented and served;
- promote and maintain safety and hygiene in connection with the handling, preparation, storage, cooking, serving, supply, transport and delivery of all foods and beverages;
- if we ask, date code food and beverage ingredients in line with the food and beverage manuals or as we may reasonably state;
- safely and properly prepare, handle, store, serve, supply, deliver or use food and beverage ingredients and take all reasonable steps to make sure that the food and beverages you supply from your business are

	<p>safe to eat or drink;</p> <ul style="list-style-type: none"> • conduct any training programs as required by the manuals or that are reasonably needed to keep your business running reasonably efficiently; • install and use the electronic equipment we reasonably require; • make sure that electronic equipment is played at the volumes and times we reasonably require; pay any fees payable for the public performance or broadcast of copyrighted works; and • record details of accidents, injuries or illnesses to anyone, property or vehicles; • conduct your business so that it does not cause risks to the health and safety of employees, non-employees or members of the public; • permit inspections of your business upon reasonable notice to your manager or directors except that mystery shopping programs can be done without notice and we or our employees may undertake up to 5 unannounced surprise visits during each year of the franchise term; • permit, allow and take part in any mystery shopper program and pay for the reasonable costs of that program including the reasonable costs of any foods or beverages bought as part of the mystery shopper program so long as the cost of the mystery shopper program is not to exceed \$500.00 per year; • comply with reasonable requisitions and recommendations issued by us after any inspection of your business or arising out of the mystery shopper programs; • give us reasonable help with test marketing, consumer research and mystery shopper programs; • do regular stock takes of your stock; • pay your creditors within their usual trading terms unless there is a bona fide dispute with the creditor and use your best efforts to try to resolve disputes between you and your creditors as soon as reasonably possible; • pay the relevant taxing authority all relevant federal, state and local taxes imposed upon you or your business unless there is a genuine dispute the subject of an appropriate appeal; • use your best efforts to try to resolve complaints about you, your business or your employees in a reasonable, fair and lawful manner and give us details of any food poisoning complaints made to you or your employees in connection with food or beverages supplied by your business; and • refund in 14 days, any money paid by us or our associates to your creditors (even if you have not asked us to pay your creditors). <p>10.4 During the franchise term, you must:</p> <ul style="list-style-type: none"> • keep the store (including any toilets and restrooms in the store) clean, tidy and in good repair and in a safe condition; • keep clean and sanitised food and beverage preparation equipment, benches, cooking utensils, tableware and other equipment coming into contact with food and beverages; • not allow your employees to smoke in food preparation areas in the
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store.

10.5 During the franchise term, you must in connection with the store and your business, comply with:

- the system standards set by us for the preparation, packing, handling, storage, cooking, presentation, supply, transportation and delivery of foods and beverages;
- the system standards set by us or that are stated in the manuals;
- set up and maintain a reasonable food and beverage hygiene program suitable for your business and make sure that your food hygiene program covers food handling techniques, personal hygiene, prevention of cross-contamination, cleaning, sanitation, pest control, waste management and storage temperatures;
- any zoning or signage requirements relevant to the store or your business; and
- laws including safety, health, sanitation, workplace, child labour laws, immigration laws, environmental, employment and tax laws applying to or affecting you, your business, the store, your employees and/or the activities of your employees and other workers.

10.6 During the franchise term, you must keep:

- your business name registered with any register or person we require;
- enough stock of fresh food and beverage ingredients as we require or that *are* needed to make and supply the Franchisor menu foods and beverages to meet market demand.

10.7 During the franchise term, you must in connection with your business make sure that: your directors and employees act professionally;

- your business is run reasonably efficiently;
- the salary of your associates does not reduce your working capital to affect the ordinary running of your business or your ability to pay your debts when due;
- all your employees and workers wear the uniforms or clothing we approve;
- all merchandise, paper goods, packaging, point of sale material, marketing materials have been approved by us; and
- your manager or your directors go to conferences, meetings and seminars as we reasonably require that are relevant to your business: and

10.8 During the franchise term, you must, if we ask:

- sign and return to us *or* our lawyers, forms for registration, surrender, cessation and/or transfer by you of your business name;
- give us a list of all names, address, phone numbers of your creditors;
- suspend or stop the supply from your business of food, beverages, goods or serving if any of them: do not comply with the system standards; *or*
- are likely to be a serious health risk or danger to members of the public; or are prohibited or restricted by law.

	<p>PART 16 RECORDS, REPORTS, ACCOUNTING</p> <p>16.1 Reports During the franchise term, you must give us by phone, fax or mail signed by one of your directors or by your manager:</p> <ul style="list-style-type: none"> • by close of trading on or before the 1st day of each week (usually Monday), a weekly report about your turnover for the previous week, plus all daily reports and summary print outs from all cash registers or point of sale systems; • by the 7th day of each month, the monthly report about your turnover and costs for the previous month; and within 3 months of your tax year ending, unaudited financial accounts in connection with you and your business for the previous tax year prepared in line with generally accepted accounting practices in Australia applicable to companies and certified as true and correct by your accountant. <p>16.2 During the franchise term, you must allow us to access electronically any financial or other information (such as details of your takings) from your cash registers or point of sale systems, computers or other electronic equipment used in connection with your business.</p> <p>16.3 Reports During the franchise term, you must, if we ask you in writing, give us within 30 days:</p> <ul style="list-style-type: none"> • a copy of your financial accounts in connection with you and your business prepared in line with generally accepted accounting practices in Australia applicable to companies for the previous tax year or for the first or last 6 months of the then current tax year and certified as true and correct by your accountant; • a copy of your latest federal and state income tax, sales tax, liquor returns and all applicable assessments for you or your business and evidence that shows that any taxes or other fees that are due have been paid in full; and <p>the originals or copies of any of your records for us to inspect and/or copy.</p>
F18	<p>Minimum standard requirements.</p> <p>2.4 (c) the Franchise Owner, the Principals and the Nominated Representative shall satisfactorily complete any initial training program, or accreditation requirements, and obtain all necessary qualifications, accreditations, permits, authorities, licences or memberships required by Franchisor or any law, regulation or code of conduct;</p> <p>8 Compliance with the Standards, Image and System - The Franchise Owner and the Nominated Representative commit to "best practice" standards of professionalism, conduct, service and performance which will not be compromised. Accordingly the Franchise Owner and the Nominated Representative agree during the Term of the Franchise:</p> <p>8.1 to strictly comply with the Franchisor Standards at all times during the conduct of the Franchised Business. In addition the Franchise Owner and the Nominated Representative shall not in the conduct of any activities outside the Franchised Business act in a manner materially inconsistent with the Standards;</p>

	<p>8.2 to strictly comply with the Franchisor Image and the Franchisor System in the operation of the Franchised Business. In addition the Franchise Owner and the Nominated Representative will not in the conduct of any business or activities outside the Franchised Business act in a manner which prejudices the goodwill or reputation of Franchisor, any company within the Franchisor Group, the Franchisor Standards, the Franchisor Image or the Franchisor System;</p> <p>8.3 to meet or exceed the Minimum Performance Criteria relevant to maintaining the Franchise, or maintaining it at the relevant Status Level of the Franchise Owner;</p> <p>8.4 to attend all initial and ongoing training relating to the Franchisor System, the Franchisor Image and the Franchisor Standards;</p> <p>15.1 Franchisor may terminate the Franchise by written notice effective immediately if either the Franchise Owner or any of the Principals:</p> <p>(j) fails to achieve the Minimum Performance Criteria for any six month period, and fails to rectify the failure during the subsequent period of six months.</p> <p>Reporting Requirements.</p> <p>5.5 Franchisor will maintain a record of all earnings of the Franchise Owner for each quarter and year and will credit all earnings and debit all adjustments. The records of Franchisor shall be conclusive evidence of the earnings of the Franchise Owner, the date of such earnings and all other relevant facts except where the Franchise Owner can demonstrate a clear and manifest error.</p> <p>9 General Responsibilities of the Franchise Owner</p> <p>The Franchise Owner and the Nominated Representative shall at all times during the currency of this Agreement:</p> <p>9.3 maintain complete, true and accurate accounting records in accordance with generally accepted accounting principles to enable verification of any detail or transaction relating to the Franchised Business;</p> <p>9.4 provide written reports to Franchisor containing all information relevant to the purposes of this Agreement and reasonably requested by Franchisor in the format required by Franchisor;</p> <p>11 Inspection and Audit</p> <p>11.1 Franchisor shall be entitled at any time to inspect and audit the Franchised Business to ensure compliance with this Agreement and in particular the Franchisor System, the Franchisor Image and the Franchisor</p>
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	Standards. 11.2 The Franchise Owner and the Nominated Representative shall answer all questions, complete any questionnaires and examinations and provide any information reasonably requested by Franchisor to verify compliance with the provisions of this Agreement or any of the Collateral Agreements.
F19	13. CONDUCT OF BUSINESS AND STAFF (a) The Member must: ... (2) conduct the Business at all times in accordance with generally accepted professional, ethical, business and financial principles and standards;

Discussion of results

Franchisors impose various types and levels of reporting requirements. Some contracts have ‘best efforts’ or ‘all reasonable efforts’ (F1, F2) while others refer to minimum performance criteria or sales targets (F7, F13). These criteria or target figures are usually unilaterally determined by a franchisor; a franchisor may impose performance requirements with little or no consultation with a franchisee.

A recent situation involved a system that required master franchisees to open a certain number of new stores. None of the master franchisees was able to meet the target number, leading to complaints of franchisor lack of due care in analysis.

The F3 contract requires a franchisee to produce two business plans, a one-year and a three-year. No such requirements are imposed on a franchisor. Other requirements in these terms may include a full-time manager, minimum hours, and specified reporting periods.

Contracts also provide for franchisor access to a franchisee’s computer systems and premises. The F14 contract provides that the franchisor can enter a franchisee’s premises at any time, ‘We may retain keys to the Business Premises and have unlimited access to the premises for the purposes of this Agreement or the Manual.’

Case law

In *Auto Masters Australia Pty Ltd v Bruness Pty Ltd*,⁵⁴⁴ the franchisor alleged franchisee breach in failing to comply with invoicing and reporting requirements using computer software and hardware supplied by franchisor. The franchisee was experiencing difficulties in accurately processing invoices using the software. The

⁵⁴⁴ *Auto Masters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286.

franchisor served breach notices over a four month period and commenced legal proceedings to terminate the agreement on same day that the franchisee served a notice of dispute. The contract contained an express term to act in good faith. The court held that the franchisor had breached its obligation to act in good faith and that the franchisor had acted unconscionably in contravention of section 51AC of the Trade Practices Act.⁵⁴⁵

Direct intervention in performance and reporting

This aspect of the relationship is another that is regulated exclusively through disclosure requirements of the contract term:

Disclosure Item 16 Franchisee's obligations:

16.1 Summary of the conditions of the franchise agreement that deal with obligations for a franchisee (or references to the relevant conditions of the franchise agreement, if attached) for the following matters:

- (a) site selection and acquisition;
- (b) requirements for starting the franchised business;
- (c) development of the site, premises, vehicles and equipment;
- (d) training:
 - (i) before the franchised business starts; and
 - (ii) during operation of the franchised business;
- (e) opening the franchised business;
- (f) complying with standards or operating manuals;
- (h) warranties and customer service;
- (i) territorial development and minimum performance criteria;
- (j) maintenance and appearance of premises, vehicles and equipment;
- (k) insurance;
- (l) marketing;
- (m) indemnities and guarantees;
- (n) participation requirements for the franchisee or its directors, management or employees;
- (o) records and reports;
- (p) inspections and audit.

There is no substantive regulation with respect to a franchisor's power to impose requirements, to change criteria or to monitor the activities of a franchisee. (For franchisee obligation to comply with pricing and or set prices see also TPA regulation

⁵⁴⁵ The court adopted the passage from *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 that, 'there is to be implied into a franchise agreement a term of good faith and fair dealing which obliges each party to exercise the powers conferred upon it by the agreement in good faith and reasonably, and not capriciously or for some extraneous purpose.'

45 and TPA regulation 48. With respect to these issues viewed in terms of an employment relationship, see Restrictive Covenants.)

Summary and measures to address imbalance of power and lack of certainty in performance standards

To enhance certainty for a franchisee, performance standards should be more about process that includes franchisees than about a franchisor unilaterally setting arbitrary standards which, if a franchisee fails to meet, constitute grounds for termination. Minimum performance requirements provide another reason for a franchisor to participate in the consultative process. The contract should ensure a franchisee's involvement in the process of determining what minimum performance assurances will be required. Otherwise, such requirements imposed by a franchisor may be determined to be unreasonable, or to constitute a *lack of due care* on the part of a franchisor.⁵⁴⁶

This is an area particularly suited to an expanded role for trust in the regulation of the relationship. A variety of non-legal methods can be used to ensure performance on both sides of the contract, such as signalling, assurances, and bonds all of which help assure franchisee performance. For example, a franchisee's act of granting discretion to franchisor in termination is a form of signalling.⁵⁴⁷ By accepting a franchisor's broad power to terminate, a franchisee offers a sort of assurance that he expects to be compliant and profitable. A franchisee demonstrates trust by allowing this exposure to possible franchisor opportunism in the exercise of rights to terminate. Flowing in the opposite direction, however, there are fewer contractual commitments made by franchisors to franchisees. Reciprocity of obligation could be increased, for example where a franchisor has some duties, for example to properly develop the system, including formulating reasonable expectations for franchisee performance, expectations which should be explained to franchisee and to which franchisee should specifically agree. Other express duties required of a franchisor might include the duty to maintain brand (stated in less discretionary language), the duty to train franchisees, and to exercise discretion in imposing requirements on a franchisee and

⁵⁴⁶ Duty of care is not an established principle but one relatively new franchise system's contract provides that a franchisee cannot sue a franchisor for failure to develop the franchise concept.

⁵⁴⁷ David Goddard, 'Long-Term Contracts: A Law and Economics Perspective' (1997) *New Zealand Law Review* 423, 442.

in accessing franchisee premise, computer systems and records. There should also be consultative processes for amendments to performance and reporting requirements. The contract should ensure a franchisee's involvement in the process of determining what minimum performance assurances will be required. Such measures would help to balance the power relationship and to improve certainty for a franchisee.

5.8 CONTRACT TERM: TRANSFER BY FRANCHISEE

The Chairman of the FCA, Stephen Giles, advised a meeting of the Franchise Consultative Panel that a franchise is ‘like a marriage, when it’s over it’s over – you do not bring in a substitute’.⁵⁴⁸ Transfer describes the arrangement in which the franchise is transferred or sold by a franchisee. A franchisor usually has unlimited capacity to sell the system or any part of its interest in it at any time without consulting its franchisees. After several years of operation a franchisee may wish to transfer its operation, but a franchisee has less latitude than a franchisor to sell its interests relating to the franchise system. Franchisors derive little benefit from franchisee transfer of the franchise, and so, there is, perhaps not surprisingly, no ‘right’ of a franchisee to transfer the franchise.

Selected results of the sample

Due to the lengthy conditions for franchisor consent to franchisee transfer, only one sample of such a clause is provided with this text. For the full text of all transfer clauses sampled please refer to **Appendix B**.

The following is a sample transfer clause:⁵⁴⁹

‘The rights and obligations of the Franchisee under this Agreement are personal to the Franchisee. Neither the Franchisee nor the Shareholders are entitled to:

(a) sell, assign, transfer or encumber in whole or in part its legal or beneficial entitlement or interest:

(i) in this Agreement; or

(ii) in the Franchisee;

(b) sub contract or delegate the performance of any of its rights, duties or obligations under this Agreement except as provided for in this Agreement, to any person without the prior written consent of the Franchisor.

20.4 Conditions of consent.

The Franchisor must not unreasonably withhold its consent to an assignment under clause 20.3. The Franchisor's consent to a sale, assignment or transfer to a proposed transferee may be withheld absolutely or granted upon such conditions as the Franchisor in its discretion considers reasonably appropriate. The Franchisor will provide its consent if:

(a) the Franchisee is not in default or arrears in respect of any payments owing to the Franchisor;

(b) the proposed transferee is in the opinion of the Franchisor a respectable,

⁵⁴⁸ 2004 ACCC Franchise Consultative Committee meeting. Stephen Giles provides information about the meeting, though not of this particular statement, at *Franchising Focus* (2005) Deacons <http://www.deacons.com.au/franchisingfocus/ff_12_04.htm> at 3 October 2005

⁵⁴⁹ System F2.

responsible, solvent and financially sound person with sufficient business experience to carry on the Business and to fully and expeditiously carry out the Franchisee's obligations under this Agreement;

(c) the Franchisee pays to the Franchisor its full costs of the investigation of the proposed transferee its directors, officers, employees and shareholders and any person who proposes to give any guarantee, indemnity or other security in respect of the proposed transferee, together with the Assignment Fee (if any);

(d) the proposed transferee signs:

(i) an acknowledgement of receipt of the Franchisee's Disclosure Document;

(ii) a new franchise agreement in the form of the Franchisor's then current franchise agreement;

(iii) such agreement or agreements as are reasonably required by the Franchisor (to be prepared by the Franchisor's solicitors at the Franchisee's expense) under which the proposed transferee agrees to be bound and perform the Franchisee's obligations under this Agreement as if it were originally named in this Agreement; and

(iv) each other document as may customarily be required by the Franchisor of other franchisees;

(e) the proposed transferee obtains all guarantees, indemnities, covenants of restraint and/or other documents or securities as the Franchisor may reasonably require for the fulfilment of the proposed transferee's obligations under this Agreement;

(f) the proposed transferee agrees at its cost to undergo or causes its Nominated Operator or employees to undergo any training programme prescribed from time to time by the Franchisor and pays to the Franchisor the full cost of doing so which cost is included in the Assignment Fee;

(g) the Franchisee agrees to execute a general release of the Franchisor's Authorised Representatives from all Claims that it may have against the Franchisor's Authorised Representatives in respect of this Agreement, or the Business and agrees to remain liable for its pre-existing obligations under this Agreement;

(h) the proposed transferee acquires all of the Franchisee's essential assets used in the Business and assumes all of the Franchisee's obligations in relation to it;

(i) the Franchisee has given the Franchisor reasonable Notice of the proposed transfer to enable it to comply with its obligations under the Code;

(j) the Franchisee has given to:

(i) the prospective transferee; and

(ii) the Franchisor, a copy of the Franchisee's Disclosure Document and the proposed transferee acknowledges receipt of it before the proposed transferee agrees to purchase the Business or the Franchise or any interest in the Franchisee; and

(k) the proposed transferee agrees to take over occupation of the Premises in accordance with the Term of the Premises Agreement either by assignment of the lease, sublease or licence or the grant of a new lease, sublease or licence to meet the then current requirements of the Franchisor and the Franchisee.'

Many contracts include a franchisor right of first refusal. When a franchisee applies to a franchisor for approval of a transfer, a franchisor may choose to

exercise this right and buy the unit. A sample of a right of first refusal clause is reproduced here.⁵⁵⁰

‘24. Right of first refusal (Franchise)

24.1 Franchisor to have right of first refusal

If at any time:

- (a) the Franchisee wishes to assign the Licence to a third party; or
- (b) a Principal wishes to transfer to a third party any shares in the Franchisee ('Shares') then, before entering into any agreement with the third party, the assignor must:
- (c) notify the Franchisor of the terms, including the price, of the proposed transaction (a 'Sale Proposal');
- (d) provide the Franchisor with all other information reasonably requested by the Franchisor to evaluate the Sale Proposal; and
- (e) provide the Franchisor with the Franchisor's then current Franchise application completed by the proposed assignee.

24.2 Franchisor to give notice

If within 30 days after receipt of the Sale Proposal and other information referred to in clause x:

- (a) the Franchisor gives notice to the assignor that it wishes:
 - (i) to operate the Franchise Business at the Location under the Approved Name, the parties will terminate this agreement and the Franchisor must pay the Franchisee in accordance with the Sale Proposal; or
 - (ii) to acquire the Shares, the assignor must transfer the Shares to the Franchisor on the terms set out in the Sale Proposal; or
- (b) the Franchisor gives notice to the assignor that it does not wish to operate the Franchise Business or acquire the Shares or does not give any notice to the assignor, the assignor may assign the Franchise or the Shares to the person named in the Sale Proposal on terms no more favourable than those contained in the Sale Proposal and subject to satisfaction of the provisions of clause.

24.3 Franchisor to purchase

If the Sale Proposal includes:

- (a) in the price payable by the purchaser consideration other than money, the price payable by the Franchisor for the Franchise or the Shares will be the monetary consideration specified in the Sale Proposal increased by the market value of the non-monetary consideration;
- (b) an offer to acquire from the assignor assets used in the Franchise Business, and the Franchisor gives notice under clause 0, the Franchisor must buy those assets; and
- (c) an offer to acquire from the assignor other assets, the Franchisor may elect to buy some or all of those assets. The price payable by the Franchisor for those assets will be their market value.

24.4 Submission of future Sale Proposals

The Franchisor's election not to operate the Franchise or acquire the Shares in accordance with this clause does not affect the obligation to submit future Sale Proposals to the Franchisor.’

⁵⁵⁰ System F2.

Discussion of results

As the sample indicates, this contract term consists primarily of franchisor constraints on franchisee transfer. Franchisors use constraints on a franchisee's right to transfer to protect a franchisor's interest in brand maintenance and to ensure the level of quality in system franchisees.⁵⁵¹ They also draft the term with an eye to deterring franchisee hold-up, such as post-contractual revision of fee schedule.

A franchisee cannot transfer his franchise unit without the prior written consent of a franchisor. A franchisee can only transfer if it complies with a franchisor's conditions,

'In addition to meeting the then-current (franchisor) franchisee qualification requirements of Sub-Franchisor, approval of a transfer to an heir, legatee or other proposed transferee may also be subject to one or more of the following conditions in the sole discretion of (franchisor) or Sub-Franchisor.'⁵⁵²

While this term is similar across systems, there is some variation in conditions for franchisor approval of transfer. Most systems demand a payment of a transfer fee. For example, F1 sets the fee at \$5000, F3 at 10 percent of purchase price, while F6 sets the fee at the greater of 10 percent or \$10,000. In addition to payment of the transfer fee there is usually a lengthy list of conditions that can provide a franchisor with justification to refuse transfer.⁵⁵³ Franchisor approval of franchisee transfer cannot be unreasonably withheld, however,

'The Franchisor must not unreasonably withhold its consent to an assignment... The Franchisor's consent to a sale, assignment or transfer to a proposed transferee may be withheld absolutely or granted upon such conditions as the Franchisor in its discretion considers reasonably appropriate.'⁵⁵⁴

Finally, there is the related issue of ownership of goodwill. In contrast to the convention in the US where local goodwill belongs to a franchisee, in Australia, contracts typically provide that goodwill belongs to a franchisor. No exception is

⁵⁵¹ Note also that a franchisor is concerned with the nature of franchisee organization (individual, partnership, corporation, trust), in order to ensure that all individuals signing the agreement will be personally liable.

⁵⁵² System F1.

⁵⁵³ See typical transfer clause in this section. For more information, see Rupert M. Barkoff and Andrew C. Selden (eds), *Fundamentals of Franchising* (1997) 65.

⁵⁵⁴ System F2.

made for local goodwill.⁵⁵⁵ Franchisors argue that this is necessary to ensure that it retains control over the use of the elements that make up the goodwill, so that these elements retain their distinctiveness to preserve the goodwill of the business for both the franchisor and the franchisees. The following is an example of a clause which appears in a similar form in most contracts sampled:

Goodwill and Intellectual Property Rights to vest in Franchisor: The Franchisee assigns to the Franchisor all existing and future goodwill arising out of the use of the System by the Franchisee; Intellectual Property Rights in improvements to the System developed by the Franchisee; and Intellectual Property Rights in any plans, specifications or advertising materials prepared by or for the Franchisee in relation to the Franchise Business... all existing goodwill and existing Intellectual Property Rights ...vest in the Franchisor and all future goodwill and future Intellectual Property Rights, on their creation, will vest in the Franchisor; and [franchisee] must do, at its own cost, all things reasonably requested by the Franchisor to enable the Franchisor to assure further its title to the goodwill and the Intellectual Property Rights...⁵⁵⁶

This limitation on a franchisee's rights regarding the goodwill of the business is often not understood by franchisees. It is also not clear, given the many other ways in which a franchisor exercises control over a franchisee's activities, why control over goodwill to protect the brand must necessarily require that a franchisee has no property interest in the goodwill.

A franchise is a wasting asset.⁵⁵⁷ As Blair and Lafontaine point out, a franchisee who contracts for a licence to use a franchisor's intellectual property needs to understand that it is purchasing something that it can never sell. There may be a significant difference in net sales proceeds from a franchise as opposed to an independent operation.

The Code was put in place in 1998; in 2008 the first franchisees will near the end of their renewal periods. Some will find that after ten years of nurturing a business, they have less to sell than they expected. In addition, a franchisee may not have control over the property or lease, the conditions of which may make the franchise more

⁵⁵⁵ Though some assert that it is understood in the sector that a franchisor may at its discretion allow a franchisee to sell part of the goodwill, there is no such contractual provision. Even if there were such a provision, the discretion of a franchisor remains. While a franchisor may permit a franchisee to sell goodwill, such a decision is made at the discretion of the franchisor; for any individual franchisee, the situation is far from certain.

⁵⁵⁶ System F3.

⁵⁵⁷ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 116.

difficult to sell.⁵⁵⁸ For these reasons accountants advise franchisees that the best time to sell is in about year seven of a ten-year term, when a franchisee will have had a return on its investment, but still an interest to sell in the remaining duration of the licence.

Seven of the nineteen contracts contained a franchisor right of first refusal. A franchisor right of first refusal is sometimes described to a franchisee as insurance that a franchisor will buy the unit if a franchisee needs to sell. This is generally not the case. A franchisor right of first refusal is a right and not an obligation of a franchisor. It does not create any rights in a franchisee. Anecdotal evidence suggests that franchisors may buy back units from distressed franchisees, but often at distress-sale prices. Some contracts include asset valuation clauses with a pre-set formula for franchisor purchase of the franchise. Dnes speculates that these clauses may provide some certainty to a franchisee.⁵⁵⁹ However, since a franchisor has the discretion to exercise its right of refusal, the set formula is more likely to benefit a franchisor. None of the contracts in the sample contained or referred to an asset valuation with respect to a franchisor right of first refusal.

A franchisor may require as a condition of completing the sale that the selling franchisee sign a termination and release form which says the outgoing franchisee gives a franchisor a general release of claims.⁵⁶⁰ Two contracts in the sample contained this condition.⁵⁶¹

Transfer: Direct intervention in transfer

Transfer is subject to substantive regulation as well as disclosure. The Code prohibits franchisors from unreasonably withholding consent to transfer.

⁵⁵⁸ Significant problems for franchise systems stem from the high rents and onerous requirements of shopping centre leases.

⁵⁵⁹ See Antony W. Dnes, 'A Case-Study Analysis of Franchise Contracts' (1993) 22 *Journal of Legal Studies* 367, 392. Article has a significant section on termination and valuation of assets to protect franchisees.

⁵⁶⁰ *The Problems Franchisees Face* (2003) American Franchise Association
<<http://www.franchisee.org/Buying%20a%20Franchise.htm#problem>> at 9 December 2006.

⁵⁶¹ Systems F2 and F17.

Clause 20**Transfer of the franchise**

- (1) A request for a franchisor's consent to transfer of a franchise must be made in writing.
- (2) A franchisor must not unreasonably withhold consent to the transfer.
- (3) For subclause (2), circumstances in which it is reasonable for a franchisor to withhold consent include:
 - (a) the proposed transferee is unlikely to be able to meet the financial obligations that the proposed transferee would have under the franchise agreement; or
 - (b) the proposed transferee does not meet a reasonable requirement of the franchise agreement for the transfer of a franchise; or
 - (c) the proposed transferee has not met the selection criteria of the franchisor; or
 - (d) agreement to the transfer will have a significantly adverse effect on the franchise system; or
 - (f) the proposed transferee does not agree in writing to comply with the obligations of the franchisee under the franchise agreement; or
 - (g) the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor; or
 - (h) the franchisee has breached the franchise agreement and has not remedied the breach.
- (4) The franchisor is taken to have given consent to the transfer if the franchisor does not, within 42 days after the request was made, give to the franchisee written notice:
 - (a) that consent is withheld; and
 - (b) setting out why consent is withheld.

The Code addresses a franchisor's right of first refusal in Disclosure Item 17.

Disclosure Item 17 Summary of other conditions of agreement

17.1 Summary of the conditions of the franchise agreement (or references to the relevant conditions of the franchise agreement, if attached) that deal with the following matters:

- (...)
- (j) Transfer of a franchise
- (...)
- (l) option or right of first refusal, if any, for a franchisor to buy the franchised business;

All the terms in the contracts sampled appear to comply with the Code as baseline standard; most contracts provide that the franchisor must not unreasonably withhold its consent to an assignment. The regulation offers protection to a franchisee, but ultimately it is still up to the courts to determine what is 'unreasonable' in withholding consent.

Summary and measures to address imbalance of power and lack of certainty in transfer

Overall, the balance of power favors a franchisor; franchisor approval of franchisee transfer can include a variety of criteria, not all of which may be anticipated by the prospective franchisee.⁵⁶² In addition, a franchisor owns the goodwill, usually controls the lease,⁵⁶³ and has an option of first refusal to buy the unit, often at according to a pre-determined formula.

Franchisees are as dependent on the good faith of a franchisor in exiting the system as they are during the course of their affiliation with a franchisor.⁵⁶⁴ A franchisee is subject to a franchisor's good faith and approval of the incoming franchisee and of the transfer itself, but a franchisor is also very much in the business of selling franchises. A franchisee can transfer his interest in the franchise, but must get consent from a franchisor with whom a franchisee is also competing to sell franchise units.⁵⁶⁵ Here again, the greater power lies with a franchisor, the greater uncertainty with a franchisee. A franchisee needs substantive protection against a franchisor opportunistically taking advantage of its position to make transfer difficult, expensive and even impossible.

⁵⁶² See typical transfer clause in this section. For more information, see Rupert M. Barkoff, and Andrew C. Selden, (eds), *Fundamentals of Franchising* (1997) 65.

⁵⁶³ Unless there is a demolition clause, in which case a franchisor may require a franchisee to hold the lease.

⁵⁶⁴ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 116.

⁵⁶⁵ The transfer fee paid to the franchisor offsets the franchisor's conflict of interest with respect to the franchisee's transfer of the unit. Of course, the fee also decreases the net proceeds available to the franchisee upon sale.

Franchisee vulnerability with respect to his right to transfer is addressed by the substantive prescriptive regulatory requirements that a franchisor cannot unreasonably withhold consent, and some parameters for the reasons a franchisor may withhold consent. Nevertheless, a franchisee remains at a disadvantage in its ability to transfer compared to that of a franchisor. More reciprocal obligations of franchisor and franchisee in transferring their interests could improve the balance of power. A franchisee also may need further substantive protection against a franchisor's opportunistically taking advantage of its position. Measures to improve a franchisee's position in transfer include collective negotiation, and further specification of procedures to protect franchisee's assets. The courts have a role to play in ensuring that franchisees are compensated for losses, but an enhanced role for the courts still would not help the many franchisees who do not litigate.

5.9 CONTRACT TERM: TERMINATION BY FRANCHISOR

Termination rights enable a franchisor to deal with under-performing franchisees, franchisee free-riding and franchisee hold-up. While a franchisor's right to terminate is important to a franchisor in maintaining uniformity and the quality of the brand, inefficient termination in which a franchisee loses more than a franchisor gains, should be discouraged. Efficiency in the termination of a franchise agreement is difficult to measure, however, especially when trying to take into account impact on a franchisor's brand. Perhaps this is why, 'Courts have traditionally applied the rule of termination at will to exclusive agency and distributorship agreements.'⁵⁶⁶ This tradition has carried over into the franchise relationship, franchisors defend the right to terminate if a franchisee performs poorly or breaches contract as a crucial aspect of maintaining brand. A franchisee, however, has a considerable investment in the relationship and deserves some protection, more than an agent or distributor that has a less significant investment in the relationship.

Franchisors argue that courts should demand only good faith and reasonable notice for termination.⁵⁶⁷ They support this argument not only with their need to protect the brand, but also with the claim that they are unlikely to terminate profitable franchisees. There are reasons, however, that a franchisor might wish to terminate, even when a franchisee is profitable. For example, a franchisor may feel that the power of a franchisee is too great, or a franchisee is too independent, or there might be conflicts over leases or financing.

From a franchisee's point of view this right of a franchisor to terminate without regard to a franchisee's investment in specialized assets leaves a franchisee vulnerable to 'hold-up' by a franchisor. A franchisee's other related contracts and rights with respect to dispute resolution may also be compromised.⁵⁶⁸

⁵⁶⁶ George Dent, 'Lawyers and Trust in Business Alliances' (2002) 58 *The Business Lawyer* 45, n247.

⁵⁶⁷ *Id.*, 252.

⁵⁶⁸ Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 *Penn State Law Review* 105, 124-125: 'As added risk to the franchisees, default of one franchise agreement may result not only in termination of the franchise at issue, but - due to cross-default clauses - result in declaration that the franchisee is in default of all the franchisee's agreements.'

Termination clauses in most contracts are lengthy, selected results of the sample are not reproduced in a table in the text, but are included in **Appendix C**.

A Sample Termination Clause⁵⁶⁹

Termination for default

If an Event of Default occurs and:

the Event of Default is not a breach of this agreement, the Franchisor may, by giving a reasonable period of notice, setting out the reasons for termination of this agreement, terminate this agreement upon expiry of the notice; and

the Event of Default is a breach of this agreement:

the Franchisor may give the Franchisee a notice:

- specifying the Event of Default and that the Franchisor proposes to terminate the agreement because of the breach;
- identifying what the Franchisor requires the Franchisee to do to remedy the Event of Default; and
- nominating a reasonable period which need not exceed 30 days (Cure Period) to remedy the Event of Default, and
- if the Event of Default is not remedied, in accordance with paragraph (B) within the Cure Period, the Franchisor may, by a further notice, terminate this agreement.

The following are Events of Default:

if the Franchisee:

- submits to the Franchisor a licence application or supporting information containing false or misleading statements or omissions of fact;
- does not open the Location for business within three months after the date of this agreement;
- does not rectify any failure to operate and maintain the Business strictly in accordance with this agreement as required by a notice from the Franchisor requiring rectification;
- sells or provides from the Business any products or services not approved by the Franchisor and continues to do so for five days after receiving notice from the Franchisor requiring the Franchisee to stop selling those products and to stop providing those services;
- does not provide items required by the Franchisor and continues to fail to do so for five days after receiving notice from the Franchisor requiring those products to be provided;
- does not pay any sum due under this agreement within seven days after receiving notice from the Franchisor requiring payment;
- assigns or purports to assign the Licence without complying with clauses
- becomes bankrupt, unable to pay its debts as they fall due, or enters into any form of insolvency administration;
- encumbers or purports to encumber the Licence without the Franchisor's approval;
- does not maintain the licences (including any liquor licences) necessary to

⁵⁶⁹ System F3.

operate the Business;
- abandons the Business or ceases or threatens to cease to operate the Business or to occupy the Location, without the Franchisor's approval;
- breaches any other provision of this agreement and fails to remedy the breach within seven days after receiving notice requiring it to do so;
- engages in any conduct, that in the Franchisor's opinion may adversely affect the System or the Business;
by the Franchisee's inaction adversely affects, in the Franchisor's opinion, the System or the Business;
- fails to maintain a good credit rating by failing to pay promptly undisputed invoices from suppliers of goods and services to the Business;
- fails to make any payments due to the Franchisor in excess of \$24,000 whether under this agreement or otherwise within 14 days of becoming due; or
- fails to comply with one or more requirement of this agreement or the Operations Manual whether or not that non-compliance is corrected after notice on two or more occasions within any three month period.
if in the Franchisor's reasonable opinion the transfer of any interest in any share of the Franchisee or the variation of the rights attaching to the shares of the Franchisee results in the effective control of the Franchisee being transferred to a competitor of any Business.

Discussion of results

In Australia most termination clauses in contracts mirror the Code provisions.⁵⁷⁰ Under Clause 21, termination in case of franchisee breach, the Code requires the franchisor to give to a franchisee reasonable notice that the franchisor proposes to terminate the franchise agreement because of the breach; to tell a franchisee what the franchisor requires to be done to remedy the breach; and to allow a franchisee a reasonable time to remedy the breach (but a franchisor does not have to allow more than 30 days). Clause 22 addresses termination where there is no breach by franchisee; this clause also requires reasonable notice to a franchisee and ensures applicability of Part 4. Clause 23 provides the circumstances where a franchisor is not required to comply with Clauses 21 or 22.

If you or the specified person fails to attend or successfully complete the initial training sessions to our reasonable satisfaction then we may, at our discretion either: by notice to you terminate this agreement; or insist on additional training at your cost.⁵⁷¹

⁵⁷⁰ There is a similar pattern in the US where termination clauses in contracts mirror FCC termination regulations. See Rupert M. Barkoff, and Andrew C. Selden, (eds), *Fundamentals of Franchising* (1997).

⁵⁷¹ System F5.

There is little reciprocity with respect to termination in franchise contracts. Termination by a franchisee is not addressed at all in most contracts, but some franchise contracts give a franchisor 30, 60, or 90 days to cure any alleged defaults.

Case law

Several cases have been decided in favour of franchisees who object to a franchisor's exercise of its rights to terminate. In *Burger King Corp v Hungry Jack's Pty Ltd*,⁵⁷² Burger King sought to terminate the Hungry Jack's franchise for failure to develop four restaurants per year. The court held that Burger King had breached an implied duty of good faith through its conduct in preventing Hungry Jack's from meeting the four restaurants per annum quota in order to develop its Australian market through a co-branding arrangement with Shell, unhindered by its contractual arrangements with Hungry Jack's after terminating Hungry Jack's' franchise agreement. The notice of termination was therefore invalid.

In *Aura Enterprises Pty Ltd v Frontline Retail Pty Ltd*,⁵⁷³ the defendant franchisor notified the plaintiff franchisee of its intention to terminate. The court held for the franchisee because the notice of termination did not identify the obligation breached.

In *Dymock's (NSW) Pty Ltd v Todd*,⁵⁷⁴ the judge held that, under the law of New South Wales, a power to terminate had to be exercised reasonably.

Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd,⁵⁷⁵ sheds some light on the reasonableness question. Six franchisees alleged that the franchisor had threatened the removal of certain products in order to compel them to surrender their franchises under value, enabling the franchisor to provide these products at its wholly-owned outlets instead. The court held for the franchisor, which it found to have acted with the legitimate purpose of promoting its commercial interests. The court did not determine if there was an obligation of good faith, as the franchisee had failed to establish breach of any applicable obligation of good faith. The court also held that

⁵⁷² *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (see also *Hungry Jack's v. Burger King* [1999] NSWSC 112).

⁵⁷³ *Aura Enterprises Pty Ltd v Frontline Retail Pty Ltd* [2006] NSWSC 902.

⁵⁷⁴ *Dymock's (NSW) Pty Ltd v Todd* [2002] UKPC 50, [2004] 1 NZLR 289.

⁵⁷⁵ *Meridian Retail Pty Ltd v Australian Unity Retail Network Pty Ltd* [2006] VSC 223 (21 June 2006)

the franchisees failed to establish their claims of misleading and deceptive conduct and unconscionable conduct.

Direct intervention in termination

Of the countries that have enacted franchise-specific legislation, only Australia and the US have substantive provisions with respect to termination. The FCC Clauses 21-23 are reproduced below:

Clause 21: Termination — breach by franchisee

- (1) This clause applies if:
 - (a) a franchisee breaches a franchise agreement; and
 - (b) the franchisor proposes to terminate the franchise agreement; and
 - (c) clause 23 does not apply.
- (2) The franchisor must:
 - (a) give to the franchisee reasonable notice that the franchisor proposes to terminate the franchise agreement because of the breach; and
 - (b) tell the franchisee what the franchisor requires to be done to remedy the breach; and
 - (c) allow the franchisee a reasonable time to remedy the breach.
- (3) For paragraph (2) (c), the franchisor does not have to allow more than 30 days.
- (4) If the breach is remedied in accordance with paragraphs (2) (b) and (c), the franchisor cannot terminate the franchise agreement because of that breach.
- (5) Part 4 (resolving disputes) applies in relation to a dispute arising from termination under this clause.

Clause 22: Termination — no breach by franchisee

- (1) This clause applies if:
 - (a) a franchisor terminates a franchise agreement:
 - (i) in accordance with the agreement; and
 - (ii) before it expires; and
 - (iii) without the consent of the franchisee; and
 - (b) the franchisee has not breached the agreement; and
 - (c) clause 23 does not apply.
- (2) For subparagraph (1) (a) (iii), a condition of a franchise agreement that a franchisor can terminate the franchise agreement without the consent of the franchisee is not taken to be consent.
- (3) Before terminating the franchise agreement, the franchisor must give reasonable written notice of the proposed termination, and reasons for it, to the franchisee.
- (4) Part 4 (resolving disputes) applies in relation to a dispute arising from termination under this clause.

Clause 23: Termination — special circumstances

A franchisor does not have to comply with clause 21 or 22 if the franchisee:

- (a) no longer holds a licence that the franchisee must hold to carry on the franchised business; or
- (b) becomes bankrupt, insolvent under administration or an externally-administered body corporate; or
- (c) voluntarily abandons the franchised business or the franchise relationship; or
- (d) is convicted of a serious offence; or
- (e) operates the franchised business in a way that endangers public health or safety; or
- (f) is fraudulent in connection with operation of the franchised business; or
- (g) agrees to termination of the franchise agreement.

Regulation of termination has been said to reduce the value and frequency of franchising in California.⁵⁷⁶ Franchisors lobby for flexibility, so that states have been circumspect in legislating, thus allowing greater discretion to franchisors.⁵⁷⁷

The 2006 Review of the Disclosure Provisions of the Franchising Code of Conduct noted that, ‘A number of submissions expressed concern about the unequal nature of a business relationship that allows a franchisor to unilaterally terminate a franchise agreement without any breach by a franchisee.’⁵⁷⁸ The government response stated that the problem would be addressed through reform to section 51AC of the Trade Practices Act 1974 in relation to unconscionable conduct. The response also stated that, ‘the Government will ask the ACCC to consider including this issue in their educational material.’⁵⁷⁹

⁵⁷⁶ James A. Brickley, Frederick H. Dark and Michael S. Weisbach, ‘The Economic Effects of Franchise Termination Laws’ (1991) 34 (1) *The Journal of Law and Economics* 101. See also Jonathan Klick, Bruce Koyabashi and Larry Ribstein, ‘The Effect of Contract Regulation: The Case of Franchising’ <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=951464> at 18 August 2007.

⁵⁷⁷ Silvana Sciarra, ‘Franchising and Contract of Employment: Notes on a Still Impossible Assimilation’ in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 263.

⁵⁷⁸ See the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007.

⁵⁷⁹ *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

Summary and measures to address imbalance of power and lack of certainty in termination

Termination is a critical issue in the franchise relation, but it is neglected at the negotiation and start-up stages. Franchisors do need to be able to terminate, 'The franchisor owes it to the shareholders and the franchised system to act promptly to preserve the brand reputation in the marketplace.'⁵⁸⁰ Research into long-term contracts suggests that such contracts should contain specific termination provisions to mitigate uncertainty and improve conditions for ongoing performance obligations through the course of the franchise unit operation.⁵⁸¹

The termination provisions should be fair for both parties. A franchisor could compensate a franchisee for losses that are not the fault of a franchisee. This should not create an undue burden for a franchisor that only terminates with good cause. Indemnification for franchisee losses can be incorporated into a franchisor's cost of doing business to be spread among all franchisees. Such provisions would increase trust between the parties, by reducing concerns of anticipated franchisor opportunism. Because of their specific investment, franchisees are more vulnerable than employees, not less so, and they are as vulnerable to franchisors' control as employees are to employers' control. A franchisee, therefore, needs at least as much protection as that afforded to employees. At a minimum they should have the assurance of fair, efficient procedures and terms for ending the business relationship.

⁵⁸⁰ Email from John B. Sivertsen to ABA forum on Franchising listserv 9 June 2006.

⁵⁸¹ David Goddard 'Long-Term Contracts: A Law and Economics Perspective' [1997] *New Zealand Law Review* 423.

5.10 CONTRACT TERM: RESTRAINT OF TRADE

Restrictive covenants protect franchisor's intellectual property, information and brand identity against franchisee free-riding. Restrictive covenants are used to address information asymmetry where control over a resource (including a system or process) is separate from control over information relevant to efficient use of the resource,⁵⁸² such problems are addressed through signalling regarding commitment to perform.⁵⁸³ This signalling function, along with its poor bargaining position generally, helps explain franchisee willingness to accept restraint of trade clauses. It also explains why there is no reciprocity of franchisor obligation here, for example, in the form of limitations on a franchisor's right to encroach.

In the US and other jurisdictions where a franchisee owns the goodwill of the franchise unit, restrictive covenants maintain the value of the penalty for franchisee failure over life of the contract. This is due to the fact that the value of local goodwill increases over time, while physical asset value may decline.⁵⁸⁴ In Australia, this is perhaps not necessary because a franchisee is not technically the owner of the goodwill (though a franchisor may permit a franchisee to include the value of goodwill in the value of the franchise at transfer).

Some franchisees argue that they should be allowed to engage in a similar business provided that they discontinue the use of a franchisor's trademarks and trade secrets and return all confidential operating materials to a franchisor.⁵⁸⁵ It is not often likely that there will be an issue about brand awareness at the location because in many cases a franchisor exercises some form of control over the premises so that a franchisee exiting the system cannot remain in the same location.⁵⁸⁶

⁵⁸² David Goddard, 'Long-Term Contracts: A Law and Economics Perspective' [1997] *New Zealand Law Review* 423, 438.

⁵⁸³ Other forms of signalling include bearing greater risk, accepting a smaller sum, and making greater up-front commitments.

⁵⁸⁴ Antony W. Dnes, 'A Case-Study Analysis of Franchise Contracts' (1993) 22 *Journal of Legal Studies* 367, 388.

⁵⁸⁵ See for example, *The Problems Franchisees Face* (2003) American Franchise Association <<http://www.franchisee.org/Buying%20a%20Franchise.htm#problem>> at 30 December 2005.

⁵⁸⁶ Jenny Buchan, 'Who is the franchisee contracting with and does it matter anyway?' (Paper presented at the 51st ICSB World Conference, 2006, Melbourne, Australia).

Franchisees argue that their position is more analogous to that of employees than business owners in the interpretation of such restraints. Once a franchisee learns to run a computer repair business or a cake shop, effectively these clauses prohibit a franchisee from continuing to ply its trade after the expiration of the franchise licence. The only way a franchisee can continue in its occupation is to participate in the franchise system.

A sample restraint of trade clause:⁵⁸⁷

S.28 Restrictions on competition

S. 28.1 Restraint of trade

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will directly or indirectly (within the Restraint Area, during the Term and for the Restraint Period without the prior written consent of the Franchisor be concerned or interested in:

- (a) any (similar) themed restaurant or café;
 - (b) any business that involves the supply or provision of any of the products or services authorised for sale in the course of the Franchisor Business; or
 - (c) any form of business similar to that of the Franchisee's business or the Franchisor's business,
- or damage the goodwill of the Franchisor or the Franchisor Business.

S.28.2 Conditions of restraint of trade

The Franchisee and its directors, shareholders, Managing Director and any other key employee of the Franchisee and any Principal shall be deemed to have breached clause x if any of those persons has an interest in a business described in clause x on its own account, or jointly or with or on behalf of any other person, firm or corporation, or is an employee, independent contractor, partner, joint venturer or agent of such a business, or has an interest in such a business through any firm, trust or corporation in which the Franchisee, its directors, officers or shareholders or any Principal may be interested as director, officer, shareholder, beneficial owner of shares, lender, advisor or otherwise.

S.28.3 Concurrent conditions of restraint of trade

Clause x shall be construed and take effect as if it were a number of concurrent separate clauses. Each such clause shall be produced by construing one of the limbs of the definition of 'Restraint Period' and one of the limbs of definition of 'Restraint Area' until all possible combinations are exhausted. Each such clause shall be severable from the other clause.

⁵⁸⁷ System F3.

S.28.4 Definitions

In clause x:

- (a) Restraint Period means:
 - (i) the period of two years; and
 - (ii) the period of one year,
 - (iii) after the termination of this agreement; and
- (b) Restraint Area means:
 - (i) the area of 15 kilometres surrounding the Location;
 - (ii) the area of 10 kilometres surrounding the Location; and
 - (iii) the area of five kilometres surround the Location.

S.28.5 Clauses enforceable

If any of the separate clauses resulting from the construction of clause x in the manner referred to in clause x is void or unenforceable for any reason, that voidness or unenforceability shall not prejudice or in any other way affect the validity or enforceability of any other such clause.

S.28.6 Franchisee's warranty for System

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will at any time, either in Australia or overseas, appropriate, use or duplicate the System.

S.28.7 Warranty for non-solicitation of customers or employees

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will at any time within 2 years after the termination of this Agreement:

- (a) solicit customers or former customers of the franchisor with the intent of taking their custom for a similar business;
- (b) employ or offer to employ any person who:
 - (i) immediately before such employment or offer of employment was employed by the Franchisor;
 - (ii) immediately before such employment or offer of employment was employed by any person who was at that time operating a business according to the System;
 - (iii) employs or offers to employ any person who was so employed at any time during the 2 years preceding such employment; or
 - (iv) directly or indirectly induce any such person to leave his or her employment.

S.28.8 Directors, shareholders and Principals covenant

The Franchisee must ensure that all directors and shareholders of the Franchisee (in the case of a company being the Franchisee) and the Principal enter into direct covenants of similar content to those contained in clauses x - x and x - x above with the Franchisor.

Discussion of results

It has been pointed out that due to a franchisor's retention of ownership of goodwill, there may be less need for restrictive covenants in Australia. Nevertheless, every contract sampled contained restrictive covenants. This could be explained by the fact that Australian franchisors, in practice, do typically allow a franchisee to include local goodwill in the transfer of a franchise unit.

Some clauses are quite abbreviated while others (in the sample, restaurants in particular) contained lengthy restraint of trade clauses. Very often these clauses are stepped to ensure a franchisor the maximum protection that the common law as applied in that jurisdiction will allow.

Case law

The restraint of trade doctrine is primarily concerned with protecting personal liberty, rather than competition generally in the market. Franchisors argue that restraints of trade contained in franchising agreements, such as the grant of an exclusive territory to a franchisee, are actually pro-competitive, and accordingly fall outside the doctrine.

At common law, any restraint of trade is prima facie contrary to public policy and void unless the restraint is reasonably necessary to protect legitimate interests. Whether a restraint of trade is reasonable depends on a number of factors. Courts consider geographical area, the scope of the activities restrained and the period of the restraint, the degree to which the restraint is necessary to protect goodwill and confidential information, customs and practices within the particular industry; and whether the restraint applies only during the term of the contract or covers a post-termination period. A different test for reasonableness of restraint applies depending upon jurisdiction.⁵⁸⁸

⁵⁸⁸ In *KA and C Smith Pty Ltd (trading as Uticolor Australia) v Ward and Ors* [1999] NSWSC 138 there was a conflict between jurisdiction where CL applies and jurisdiction where legislation addresses defects in CL.

In both *Stained Glass Overlay Australasia Pty Ltd and Ors v Kevind James Rea and Anor* and *Sureslim Australia v Mansell* courts upheld restraint of trade clauses in the franchise agreements.⁵⁸⁹

In *KA and C Smith Pty Ltd (trading as Uticolor Australia) v Ward and Ors* the court considered whether the restraint of trade clause was too broad given the need to balance the interests of the parties. It considered the interests of the franchisor,

‘the franchisor has an interest at stake which is analogous to the purchaser’s goodwill. It has an interest in protecting the patronage built up through the operation of the franchise, which may be lost if the franchisee is permitted to compete without restriction. The franchisor also has an interest in preserving the confidentiality of confidential information provided to the franchisee, which could be used by the franchisee to compete with the franchisor if there were no restraint.’⁵⁹⁰

On the other hand, the interests of the franchisee must also be considered,

‘the franchisee has an interest in protecting the goodwill of its business. The customers are customers of the franchisee’s business, though the franchisor also has an ‘interest’ in the customers since they are attracted to the business as a franchise business.’⁵⁹¹

The holding pursuant to NSW Statute was that there was an unreasonable restraint of trade which was void at common law. However, because the Restraints of Trade Act 1976 (NSW) applied, the restraint was held to be valid.⁵⁹²

⁵⁸⁹ *Stained Glass Overlay Australasia Pty Ltd (ACN 006 311 762) and Ors v Kevind James Rea and Anor* [1998] WASC 325, and *Sureslim Australia v Mansell* [2002] NSWSC 945.

⁵⁹⁰ *KA and C Smith Pty Ltd (trading as Uticolor Australia) v Ward and Ors* [1999] NSWSC 138., 25

⁵⁹¹ *Ibid.*

⁵⁹² Section 4(1) of the Act.

Direct intervention in restraint of trade:

Disclosure Item 18 requires a disclosure of the nature of any restraint of trade agreement:

Disclosure Item 18: Obligation to sign related agreements

18.1 Summary of any requirements under the franchise agreement for the franchisee or directors, shareholders, beneficiaries, owners or partners of the franchisee to enter into any of the following agreements:

(...)

(e) an agreement not to carry on business within an area or for a time after the franchise agreement is terminated.

With respect to both to restraint of trade and non-competition clauses, apart from this disclosure, common law rules apply.

Summary and measures to address imbalance of power and lack of certainty in restraint of trade

With respect to restraint of trade clauses on a franchisee compared with restraints on franchisor encroachment, in the interests of trust and reciprocity of the relational contract, entitlement of a franchisee to similar protection of his business for the duration of the franchise contract would improve the balance of power.⁵⁹³

⁵⁹³ American Franchise Association, *The Problems Franchisees Face* (2003) <<http://www.franchisee.org/Buying%20a%20Franchise.htm#problem>> at 30 December 2005.

5.11 CONTRACT TERM: COLLECTIVE AGREEMENT

To provide further assurance of franchisor discretion, some franchise contracts include a collective agreement clause (also known as an ‘agree to agree’ or ‘come along’ clause) that binds a franchisee to cooperate with any decisions of the majority, whether or not it agrees. Contracts may also include terms that suggest a franchisor can unilaterally change certain aspects of the agreement, for example, ‘standard franchise agreement means the standard terms and conditions pertaining to the grant of a franchise by us as amended by us from time to time in our absolute discretion.’⁵⁹⁴

Table 5.8 provides a sample of the exact language used in collective agreement clauses in Australian franchise contracts.

Table 5.8: Examples of Collective Agreement or ‘Agree to Agree’ Clauses

F7	Variation: An amendment or variation to this Agreement is not effective unless it is in writing and signed by the parties.
F3	IMPROVEMENT TO THE SYSTEM: You must incorporate into the franchise business all changes to the system stipulated by us from time to time. Any development or improvement to the system created by you or on your behalf must be specified and notified to us. You agree that we own the rights to any improvement or development to the system made by us or by you (or on your behalf) from time to time.
F3	Come along: You will abide by any decision of the majority even if you are not one of the majority.

The Franchising Code of Conduct Disclosure Item 17.1 requires a summary of the conditions that deal with the following matters variation.⁵⁹⁵ There is no other sector-specific regulation with respect to amendments to the agreement, but the TPA section 51AC (3) may apply (see below).

Item 17 of the Review considered the right of unilateral change to a franchise agreement. The Review noted that, ‘Franchisors are currently able to include in the franchise agreement the right to unilaterally amend arrangements between themselves and franchisees.’ The Review also noted that, ‘The original Franchise Bills proposed that such clauses in a franchise agreement should be null and void.’ A franchisor does

⁵⁹⁴ See System B (AF). There was some discussion of regulating against the unilateral revision of contracts at a 2004 ACCC Franchise Consultative Committee meeting. Stephen Giles, who attended the ACCC Consultative Committee meeting, provides information at: *Franchising Focus* (2005) Deacons <http://www.deacons.com.au/franchisingfocus/ff_12_04.htm> at 3 October 2005.

⁵⁹⁵ Item 17.1(b).

need the latitude to exercise control in the best interests of the system, but because of the potential to adversely impact a franchisee, the review advised measures to alert franchisees to the risks of such clauses, and stated that, ‘it is important that the ACCC ensure that such risks are clearly spelt out in the educational material they provide to prospective franchisees.’⁵⁹⁶

The Review’s recommendation that a Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements was not agreed to by the government, which in its response stated that the problem would be addressed through reform to section 51AC of the Trade Practices Act 1974 in relation to unconscionable conduct ‘where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct.’⁵⁹⁷

⁵⁹⁶ See the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007, 41.

⁵⁹⁷ Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

5.12 CONTRACT TERMS ANALYSIS RESULTS SUMMARY

Franchisee Independence (See Table 3.1)

Summary: In clauses that describe the franchise relationship, such as the ‘Independence of Franchisee’ clause, a franchisor disclaims relationship of partner, agent, employee, but retains control over the activities of franchisees. Relationship attributes of agency, partnership, and employment do exist in franchising, but a franchisor uses this clause to disclaim these qualities of the relationship and avoid the various forms of liability that they may engender.

Regulation: There is no regulation with respect to this contract term.

Recommendations: These roles should be more clearly and definitively understood by the parties as well as mediators, courts and legislators. As long as the relationship remains poorly defined, a franchisor has greater freedom to impose its own interpretations and requirements and it is more difficult for franchisees to protect themselves or to benefit from court interpretation and regulation that protects them in the various roles of vulnerability in which they find themselves in the franchise relationship.

Scope of Grant

Summary: The Scope of Grant clause delineates and effectively limits the rights of a franchisee, while specifically reserving rights, such as use of the intellectual property, and discretion to a franchisor. Most grants are not exclusive, so that in most cases a franchisor retains the right to encroach. There is often little or no protection for a franchisee against a franchisor right to encroach, and many contracts often specifically reserve rights and discretion to a franchisor in order to avoid court intervention, for example, implying a duty of good faith.

Regulation: This term is subject only to Franchising Code of Conduct (FCC) Disclosure Item 8 that requires disclosure.

Recommendations: Balance of power could be improved through cooperative and collective action, reciprocal commitment, and sharing of benefits of expansion by a franchisor. Uncertainty would be helped through clear specification of details, proper selection of franchisees, and carefully delineated territories, and business and development plans.

Right of Renewal

Summary: The ‘right, the ‘right of renewal’ is not actually a right but rather a set of conditions restricting a franchisee’s ability to renew. If a franchisee is permitted to renew, renewal must be exercised within specific parameters of a franchisor’s conditions, set largely at a franchisor’s discretion.

Regulation: This term is subject only to FCC Disclosure 17 Summary of the conditions of the agreement.

Recommendations: Balance of power might be helped by collective action, while greater certainty could be achieved if the initial contract duration of the contract were sufficient to provide a franchisee return on investment. Both sides need clearer understanding of how long the individual franchisee needs to be in business to recoup his investment, as well as of what needs to happen for franchisee to exercise a right of renewal.

Franchisor Advertising

Summary: Advertising is a franchisor obligation. While each franchisee pays into the marketing fund, generally franchisees have no say individually or collectively in franchisor promotional activities. A franchisor has discretion that contributes to the risk of franchisor opportunism and to uncertain conditions for its franchisees; franchisees pay but have no say in franchisor promotional activities.

Regulation: This term is subject to FCC Disclosure Item 12 re Marketing or other cooperative funds and FCC Sub-clause 17: Financial report by franchisor re marketing and other cooperative funds.

Recommendations: Consultative processes again could help the balance of power while certainty could be enhanced through substantive provision outlining specific franchisor obligations or warranties regarding advertising. If a franchisor cannot be held to specific obligations over the long term, then procedures may help to ensure proper consideration of the interests of a franchisee. Franchisee participation, for example, can help ensure that a franchisor is performing, assurances of franchisee inclusion in decision-making processes and/or required involvement of the Franchisee Advisory Council (FAC).

Franchisee Supply

Summary: A franchisor controls, while a franchisee agrees to comply.

Regulation: This term is subject to regulation in the form of FCC Disclosure Item 9.1 for a franchisor's requirements for supply of goods or services to a franchisee and FCC Disclosure Item 10.

Recommendations: With respect to supply a franchisor controls, while a franchisee agrees to comply; this too illustrates an imbalance of power over future conditions that contributes to uncertain conditions for franchisees. To improve certainty the procedures for franchisor approval should be specified as clearly as possible. Collective participation, in particular measures that allow franchisees to play a role in negotiating supply can address balance of power, also franchisee buying cooperatives for larger systems, and authorization for franchisee to shop from among several franchisor approved suppliers.

Franchisee Minimum Performance and Reporting

Summary: Franchisee may be required to work full time or certain minimum number of hours on franchise business also must meet performance targets that are set and can be changed by franchisor at its discretion. All franchisee books, records, computer systems are available to franchisor, but the reverse is not true. Again, these terms of the contract indicate uncertain conditions for a franchisee, while a franchisor enjoys power and discretion.

Regulation: Applicable regulation consists of FCC Disclosure Item 16.1 Summary of the conditions of the franchise agreement that deal with obligations for a franchisee.

Recommendations: Measures to address imbalance of power include non-legal methods to ensure performance on both sides of the contract, for example, signalling, assurances, bonds, and reporting requirements. Also greater reciprocity of obligation is needed; a franchisor should have some duty to properly develop the system and should establish consultative processes for amendments to the system. To address uncertainty performance standards should be more about process than setting an arbitrary standard. In this context, collective action and participatory processes can be helpful.

Transfer

Summary: Contract terms relating to franchisee transfer put control over a franchisee's ability to transfer in the hands of a franchisor. All rights and obligations of franchisee are personal to a franchisee, and a franchisee can only transfer if it meets the conditions of a franchisor, while a franchisor is unfettered in its ability to transfer its rights and obligations under the contract. Again, there is imbalance of power in favour of a franchisor and uncertainty for a franchisee.

Regulation: There is substantive regulation that affects this term. FCC Clause 20 Procedural Requirements for Transfer of the franchise with respect to franchisor's consent to transfer of a franchise and FCC Disclosure Item 17.1(j) Summary of the conditions of the franchise agreement (or references to the relevant conditions of the franchise agreement, if attached) that deal with transfer of a franchise.

Recommendations: Measures to improve a franchisee position include collective negotiation, and further specification of procedures to protect franchisee's assets can address uncertainty. Power imbalance can be helped by substantive protection for franchisees against a franchisor opportunistically taking advantage of position to make transfer difficult and expensive.

Termination

Summary: Franchisee has specific obligations; if breached franchisor may terminate. Franchisor has vague obligations; there is little recourse for franchisee if franchisor does not perform.

Regulation: There is substantive regulation that affects this term in the form of FCC Clause 21 Termination - breach by franchisee (reasonable notice, reasonable time to remedy the breach⁵⁹⁸, and dispute resolution as per Part 4); FCC Clause 22 Procedures for Termination - no breach by franchisee (notice of breach and dispute resolution as per Part 4); and FCC Clause 23 Procedures for Termination - special circumstances (circumstances where franchisor does not have to comply with clause 21 or 22).

⁵⁹⁸ According to *Trade Practices (Industry Codes - Franchising) Regulations 1998 (No 162)* (Cth), Clause 21, the maximum notice required is 30 days.

Recommendations: Measures to address imbalance of power and uncertainty include specific termination provisions to mitigate uncertainty and improve conditions for performance obligations. Inefficient termination should be discouraged. Protections afforded to employees should be considered as should compensation to franchisees for losses that are not the fault of a franchisee.

Restraint of Trade

Summary: With respect to restraint of trade a franchisee is subject to detailed restraints to the maximum extent the law will allow, while a franchisor is generally subject to minimal restraints, if any, on its business (compare Scope of Grant).

Regulation: This clause may be subject to FCC Disclosure Item 18 that addresses restraint of trade if a franchisee is required to sign an agreement in connection with restraint of trade.

Recommendations: To address imbalance of power and uncertainty, in the interests of trust and reciprocity of the relational contract, a franchisee should be entitled to similar protection that a franchisor has to encroach.

Collective Agreement

Summary: Franchisor in most cases can make unilaterally. Franchisees must comply even if they do not agree. Franchisor can also change operations manual, computer systems, and sometimes control over franchisee premises.

Regulation: The Code of Conduct does not address such provisions, regulating only through FCC Disclosure 17.1 Summary of the conditions that deal with variation.

Recommendations: The collective agreement clauses reinforces imbalance of power and uncertainty. Analogies may be drawn with other organisational paradigms such as rules regarding minority shareholders,⁵⁹⁹ but there is always the option of banning the use of such language altogether in franchise contracts as the original Franchise Bills proposed.

Conclusions based on contract terms analysis results summary

⁵⁹⁹ Watson and Gunasekara, 'Regulating Business Format Franchising: Familiar Solutions for Novel Problems' (2006) 12 *NZBLQ* 174. Whitford, William C., 'Symposium: Relational Contracts and the New Formalism' [2004] *Wisconsin Law Review* 631

While it is difficult to make generalizations about diverse contract terms, some patterns have emerged. First, imbalance of power is evident. Second, uncertainty for a franchisee is strongly evident and reinforced by the contract. High levels of discretion to one contracting party indicate an imbalance of power in the contracting relationship. The contract terms analysis shows that the contract terms consist largely of lengthy and detailed obligations on a franchisee, and high levels of discretion to a franchisor in the performance of the contract as well as transfer and termination, even though these aspects are subject to some substantive regulation. As the standard form and relational nature of the contract would suggest, throughout the terms analysis, a franchisor has control. Franchisor interests are protected and franchisor risks are minimized. This is accomplished largely by shifting risk to franchisees that enter the relationship with less power and so are persuaded to grant high levels of discretion to franchisors.

With respect to certainty, where contractual obligations are vague, flexibility and discretion accrues to franchisor. In both the case of a franchisee and a franchisor obligation, then, uncertainty is subject to a franchisor's judgment or discretion, never that of a franchisee. Discretion to accommodate the long-term nature of the contract thus accrues to a franchisor. High levels of discretion accorded to a franchisor not only indicate an imbalance of power, but also high levels of uncertainty for and risk to a franchisee.

The statutory regulation applicable to these contract terms is summarized here as follows: Of the ten clauses seven were regulated using the tool of disclosure exclusively; one was regulated using disclosure and substantive regulation (transfer procedures); one was regulated using only substantive regulation (termination procedures); and one (Franchisee Independence) was not subject to any Code of Conduct regulation. There is a heavy reliance on disclosure, but imbalance of power and uncertainty for a franchisee persist. The next chapter will explore the reasons why disclosure is ineffective.

The findings of this chapter are that contract terms reflect an imbalance of power in favour of a franchisor and uncertainty for a franchisee, providing evidence that the stated goals of regulation are not met. Alternative measures have been considered that might ameliorate the imbalance of power and uncertainty manifest in the various contract terms. One important step is to better define the relationship and educate

participants, third parties, courts and regulators about the implications of the relationship (for example, the franchisee independence clause).

Procedural safeguards can help ensure fairness and efficiency, provide more information and enhance certainty, and contribute to a balancing of power in the relationship. These might include:

- procedures outlining how franchisees are selected, how franchisees are matched to units and territories, and how franchisors can make changes to territory allocations
- procedures for approval of new brands or suppliers to ensure franchisor's reasonable control over price and quality; as well as
- procedures for ending the business relationship, transfer and termination, franchisor insolvency, etc.; and, most importantly,
- Procedures for cooperation and consultation that encompass collective input from franchisees. It is important that franchisees not only not be prohibited from acting collectively, but that they be encouraged to do so.

Prescriptive measures can also help to redress imbalance of power and uncertainty for a franchisee. These might include:

- further specification of procedures to protect franchisee's assets;
- reciprocal commitments (for example, with respect to the scope of grant as opposed to restraint of trade and performance standards that are in place for franchisees but not for a franchisor,); and
- specificity where possible.

Performance standards for both parties can help to enhance reciprocity such as business plans required of both parties, not just of franchisees; collective franchisee participation in review of promotional activities for the brand

These are just a few measures that could be implemented to address the imbalance of power and lack of certainty in the relationship. There is ample scope in these measures for participation of franchisees, especially collectively and in collaboration with franchisors and the regulator. The most obvious are in the areas of information and education of existing and prospective franchisees, conflict management, as well

as collective buying, and collective input in marketing and promotions. Some of these may be appropriate for some systems, some may not.

5.13 SYMMETRY IN DISCRETION

Imbalance of power and uncertainty lead to high levels of discretion for a franchisor. Franchisor discretion in turn leads to greater imbalance of power and uncertainty for a franchisee. This manifests itself in relatively low levels of contractual obligation for a franchisor with high levels of discretion to a franchisor. A franchisee on the other hand, takes on high levels of contractual obligation and must perform these obligations under conditions of relative uncertainty. The contracts could not be said to contain reciprocal commitments.⁶⁰⁰ These conditions add to the asymmetry that characterizes the relationship.

The connection between discretion and the concepts of balance of power and uncertainty introduced in Chapter One has run as a subtext throughout this dissertation. Chapter Three discusses the asymmetry of information and the need to preserve uniformity which leads to franchisor power and discretion. Chapter Four analyses the standard form and relational qualities of the contract that together lead to high levels of power and discretion in a franchisor.

This chapter gives examples of asymmetry of discretion and of asymmetry of obligation in franchise contracts. The following two excerpts from contracts in the sample provide for franchisor discretion with respect to general conditions and terms and changes thereto (italics added):

- ‘Franchisee further acknowledges and agrees that (franchisor) shall have sole control and discretion over the development of the System and the designation of the Products and services to be offered in the Store, and that Franchisee will comply with franchisor’s requirements in that regard.’⁶⁰¹
- ‘Standard franchise agreement means the standard terms and conditions pertaining to the grant of a franchise by us as amended by us from time to time in our *absolute discretion*.’⁶⁰²

Another contract in the sample contains several provisions that ensure franchisor discretion to exercise control in various aspects of performance (italics added):

⁶⁰⁰ Recommended by Goddard as a desirable feature of the longer duration contract. See David Goddard ‘Long-Term Contracts: A Law and Economics Perspective’ [1997] *New Zealand Law Review* 423.

⁶⁰¹ System F1.

⁶⁰² System F5.

- ‘The Franchisee must not sell the Products from a removable site or vehicle, whether within or outside the Territory, without the express prior written consent of the Franchisor. The consent of the Franchisor may be granted or withheld at the Franchisor’s *absolute discretion* and on such conditions as the Franchisor shall determine.’
- ‘The Franchisee may not establish or operate another business similar to the Business, whether inside or outside the Territory, without the prior written consent of the Franchisor. The consent of the Franchisor may be granted or withheld at the Franchisor’s *absolute discretion and on such conditions as the Franchisor shall determine.*’
- ‘...the Franchisor has reserved its rights to decide in its *absolute discretion* how Commercial Customers will be serviced;’
- ‘...the Franchisor has reserved its rights to decide in its *absolute discretion* how special events will be serviced.’⁶⁰³

Most franchise contracts contain fewer obligations for a franchisor than for a franchisee. A franchisor’s contractual obligation usually involves some commitment to maintain and promote the brand and to provide training, but these obligations are almost always to be carried out at a franchisor’s discretion. One of the contracts in the sample is arranged with an ‘Our Obligations’ section for a franchisor and a ‘Your Obligations’ section for a franchisee, and so provides a neatly pre-packaged example of the ratios of franchisor to franchisee obligations. The franchisor’s ‘Our Obligations’ section is two pages in length and consists of fourteen items, many of which can be performed according to franchisor discretion, while the franchisee’s ‘Your Obligations’ section covers four pages and consists of 58 items, many of which are highly specific and/or are also subject to franchisor discretion. See Table 5.9 below.

Table 5.9: Comparison of Franchisor and Franchisee Obligations⁶⁰⁴

FRANCHISOR OBLIGATIONS
1. manage and operate our business in a professional and competent way.
2. share with you our knowledge and experience in the formation and operation of the franchise business.
3. make our manuals available to you and grant you a licence to use those manuals for the term of this agreement.

⁶⁰³ All four provisions taken from System F2.

⁶⁰⁴ System F5.

4. provide advice and assistance with:
a. the products to be offered for sale;
b. the display of these products;
c. customer service;
d. marketing and selling;
e. training;
f. operation of the franchise business;
g. site location and lease negotiation;
h. initial hiring of staff;
i. store design and fitout; and
j. placing your initial product orders
5. provide training sessions at times and places reasonably selected by us. You and the specified person in item 13 and where necessary, your employees, must attend these training sessions at your cost.
6. we will help you in selecting suppliers of the products you will sell and the other items necessary for you to run the franchise business.
7. If you request, we will provide you with a list of suppliers from whom you may obtain authorised products that you can sell in the franchise business.
8. negotiate with suppliers for discounts and allowances for the benefit of us and all our franchisees including you.
9. give you various marketing material for use by you. The nature and extent of this material will be <i>at our discretion</i> .
10. We will supply personnel at our cost to assist you in the opening of the franchise business for such time as we reasonably determine.
11. supply you with the recommended retail prices for the products to be sold by you.
12. subject to the terms of any individual franchise agreement, endeavour to treat all our franchisees equally.
13. If we need to give our consent or approval we must consider it promptly and must be fair and reasonable in giving or withholding it. We may also require you to obey any reasonable terms before we give our consent or approval.
14. We and you agree to comply with the terms of the Franchising Code of Conduct. The Franchising Code of Conduct is deemed to form part of this Agreement and will prevail where there is a conflict between this agreement and the Franchising Code of Conduct.

YOUR OBLIGATIONS
1. You must keep the premises clean and tidy and decorated and equipped in accordance with our general plans and requirements for a store fitout.
2. If we change these plans and requirements we must notify you and you will at your expense comply with these changes within 30 days of this notice. Otherwise, you agree not to make any alterations of any nature to the premises without our written consent.
3. You will use the premises only for the operation of the franchise business.
4. You will commence trading on the date in item 5.

5. You must hire at your cost an experienced staff member of ours for a minimum of 4 weeks from the date in item 5 to assist you in the introduction of our standards and requirements. You must pay the rate specified by us for this staff member and any of their reasonable travelling and accommodation costs.
6. You must keep the premises open for business during the reasonable hours set by us and during the hours, if any, set down in the lease of the premises.
7. You will ensure that the person in item 13 will supervise and operate the franchise business diligently, in accordance with our standards and requirements, so as to maximise the revenue and profit of the franchise business and to reflect favourably on you and us and our other franchisees. You and the person in item 13 will devote full time and attention to the operation of the franchise business and to any other of our franchised businesses owned by you.
8. You will comply at your cost with any changed marketing or operational practices that we wish our franchisees to implement.
9. You are not allowed without our consent to make any representation or warranty about the franchise business or the products offered for sale other than those that are permitted by this agreement and the manuals.
10. You must exercise your best efforts at all times to achieve the highest possible level of sales of the authorised products from the premises. We may meet with you from time to time to discuss your sales performance. However, you shall be responsible for achieving the sales performance at all times and we have no responsibility in this regard.
11. You must ensure that your gross sales in any 12 month period do not fall below the minimum sales level set out in item 18 of the Schedule.
12. If your annual gross sales fall below the minimum sales level in any 12 month period, the we may notify you of the fact in writing and may in our absolute discretion require you to undertake any or all of the following steps at your cost: <ul style="list-style-type: none"> ▪ meet with our representative to review your sales performance, ▪ attend such meetings or complete such further training sessions as required by us, ▪ make such changes to the franchise business as we may reasonably require
13. If, despite attending to the requirements of [ITEM 12], your annual gross sales do not increase to a level above the minimum sales level then we may notify you of the fact in writing and in our absolute discretion either require that further training and changes are required as per [ITEM 12], or if there is no valid external commercial reason for the failure to achieve the minimum sales level, may elect to terminate the Agreement by written notice.
14. You are liable for the cost of purchasing your merchandise.
15. You agree to
a. remove at our request any merchandise which does not, in our opinion, meet our standards.
b. make available for sale from the premises at least the minimum product range that we determine should be stocked by our franchisees generally.
c. Have on hand at least the minimum stock levels deemed appropriate by us for a store of your size and turnover from time to time.

d. display and sell only authorised products.
16. You must:
a. display the merchandise for sale in accordance with our specifications from time to time.
b. remove from display any damaged or soiled merchandise.
17. You must give at all times efficient and courteous service to all your customers. You must act with honesty and integrity in all your dealings with your customers, suppliers and employees. You agree to follow the standards set by us for the operation of [franchise system] stores including the:
a. methods of buying, displaying, storing and selling products.
b. safety, maintenance, cleanliness, operation and appearance of the premises.
c. appearance of you and your employees and uniforms or clothes to be worn in conducting the franchise business.
d. use of credit card services which we arrange.
e. use of advertising and marketing materials.
18. We have various authorised gift certificate systems in use in our stores. Details of these systems can be obtained on request. You will honour gift certificates issued under any of these systems irrespective of the source of issue.
19. You will accept by way of return or exchange any merchandise purchased from any The [franchise system] store within Australia or New Zealand, provided that such return or exchange complies with the returns and exchanges policy issued by us from time to time.
20. You will implement the procedures outlined in our returns and exchanges policy in relation to inter-store transactions.
21. You will comply with any variations to the above procedures implemented by us from time to time.
22. You agree that any transfer of merchandise between you and any other The [franchise system] store will comply with the inter-store stock transfer policy that we issue from time to time.
23. You acknowledge that adherence to our policies, manuals and standards is essential for the creation and maintenance of the uniformity upon which the goodwill of the system depends. You agree to abide by the policies, manuals and standards issued or set by us from time to time.
24. You and the covenantor jointly and severally agree that during the term of this agreement, and for a period of 12 months after its termination you and the covenantor will not, in any capacity whatsoever, carry on any business substantially the same as the franchise business or involving the sale of any goods similar to or competitive with any of the authorised products within the territory or within the territory of any other franchise granted by us in Australia or New Zealand.
25. We are the owners of the know-how and we will disclose such know-how to you. We grant you a non-exclusive licence to use the know-how throughout the term of this agreement.
26. You will not acquire any interest in the know-how, other than the right to use it in the development and operation of the franchise business during the term of this agreement.
27. You agree that this know-how is our property, and is disclosed to you on the

condition that you:
28. will not use or duplicate the know-how in any other business or capacity.
29. will maintain the confidentiality of the know-how during and after the term of this agreement.
30. will not make unauthorised use or disclosure to your employees.
31. You must obey any law or contract that requires you to do anything concerning the premises, the franchise business or this agreement.
32. You operate the franchise business and occupy the premises at your own risk. You also carry out any building work in the premises at your own risk.
33. You will use your best endeavours to assist us in any action or demand due to any damage, loss, injury or death occurring in or about the premises and the franchise business, except to the extent that we cause this by any act of negligence.
34. You indemnify us against action or demand due to any damage, loss, injury or death caused by:
35. an act of negligence by you, your employees or your agents, or
36. the use or occupation of the premises by you, your employees or your agents, or
37. the conduct of the franchise business by you, your employees or your agents,
38. except to the extent that we caused this by an act or negligence.
39. This indemnity will continue after the termination of this agreement.
40. You must have current insurance for all the following during the term of this agreement, at your cost:
41. public liability insurance for the amount in item 14.
42. industrial special risks policy for the usual risk and covering all your property in the franchise business for its full value.
43. workers' compensation.
44. loss of income for the amount stated in item 15.
45. such other insurance as we require from time to time.
46. If you do not, we have the right but not the obligation to take out insurance on your behalf. If we do take out insurance on your behalf, we must give you notice and you must reimburse us immediately.
47. You must provide evidence of the insurance to us upon our request.
48. The relationship between you and us is strictly that of franchisee and franchisor. You are not and must not represent yourself as the agent, representative or employee of us for any purpose. You have no authority to create any obligation of any kind, express or implied, in the name of or on behalf of us.
49. At our request, you will show on the premises and in all records and business forms and stationery in a manner satisfactory to us that you are the owner of the franchise business under franchise from us.
50. You will maintain the contents of the franchise business in excellent working condition. If any part needs replacing you will replace it with a part that fits our specifications.
51. You are responsible for the hire and fitting out of your employees and for the terms of their employment.
52. You must not approach or attempt to hire any person working in any other The [franchise system] store or location without the written consent of the

owner of that store or location.
53. You must maintain sufficient trained staff to operate the franchise business properly.
54. You must ensure that your staff are trained in accordance with our training policies, procedures and standards issued by us from time to time.
55. You will comply with any other agreement to which you are a party and which relates in any way to the operation of the franchise business.
56. We and you agree to comply with the terms of the Franchising Code of Conduct. The Franchising Code of Conduct is deemed to form part of this Agreement and will prevail where there is a conflict between this agreement and the Franchising Code of Conduct.
57. You must pay all creditors and comply with their trading terms. If you do not, we have the right but not the obligation to pay your creditors. If we do pay your creditors we must give you notice and you must reimburse us immediately.
58. You will abide by any decision of the majority even if you are not one of the majority.

In the contracts sampled there are no procedural standards connected with the terms granting discretion to a franchisor, for example in franchisor training, support or promotional activities. Franchisee obligations, on the other hand, are typically subject to strict standards, schedules, and targets, often to be set and/or changed at the sole discretion of a franchisor. Not all franchisee obligations, however, are strictly specified at the outset. It is not uncommon that franchise contracts impose requirements on a franchisee that fail to clearly specify the nature of the contractual obligation. Minimum performance is one example where the contractual term allows a franchisor to unilaterally impose and vary exact requirements through other schedules and documents such as the operations manual. With respect to certainty of contractual obligations, those assumed by a franchisee are often unclear, subject to change by a franchisor through the operations manual, technical and training manuals and other documents, as well as by relying on the collective agreement clause, or on provisions in the contract that accord to a franchisor broad discretion. Even the flexible, open-ended requirements of franchisee are to be performed at a franchisor's discretion.

The lack of reciprocity is clear. Contracts in the sample contain few performance standards for a franchisor. Franchisor obligations are open-ended, to be performed at a franchisor's discretion. Because of the uncertainty in the relationship over time, where they do occur, performance standards are generally not specific, but rather rely on reasonableness or procedural standards. A reasonableness requirement with respect to franchisor contractual obligation is common in franchise contracts.⁶⁰⁵

Franchisor legal advisers find any such requirement unacceptable. They argue that discretion offers insufficient protection for a franchisor, 'there is general agreement among the courts about one thing—the (implied covenant of good faith) requires that parties to an agreement exercise discretion "reasonably."' In order to avoid even the requirement to act reasonably a franchisor is counselled to,

'go hunting for the "D" word' replacing it with 'the (franchisor's)"right"... Better yet, make clear somewhere in the agreement that whenever the franchisor is reserving a right, it has the uncontrolled or unfettered right...Almost all courts agree that the covenant of good faith and fair dealing does not trump an express right.'⁶⁰⁶

The franchise contract binds a franchisee over a period of years. A franchisee's extensive obligations are specified in detail and can be strictly enforced. If a franchisee fails to meet any of them, a franchisor can terminate for breach of contract. A franchisor, on the other hand, is subject to a minimum number of requirements, as a franchisor requires flexibility and discretion in operating the system. Because neither a franchisee nor a franchisor can predict future circumstances, a franchisee has to trust its franchisor, and hope that a franchisor will act in a franchisee's best interests. Unfortunately, given the many conflicts of interest in the relationship, this is not always the case.

5.14 CHAPTER CONCLUSION

Chapters Three and Four outlined the market interaction in franchising and the nature of the franchise contract, both of which contribute to the conditions of imbalance of power and uncertainty. The market interaction is weighted in favour of a franchisor and is fraught with uncertainty for a franchisee. The standard form and relational

⁶⁰⁵ The content analysis of the contracts sampled showed a high frequency of a 'reasonable' standard.

⁶⁰⁶ William L. Killion, 'Putting Critical Decision-Making Where It Belongs: Scouring the Franchise Agreement for the "D" Word' (2005) 24 *Franchise Law Journal* 228, 229-230.

contract allows a franchisor to take advantage of the imbalance and uncertainty of the market and the contract form exacerbates these conditions.

Chapter Five demonstrates that, in practice, contract terms are drafted to reflect and reinforce imbalance of power and franchisee uncertainty. It provides evidence from real franchise contracts that contract terms do not reflect the attainment of the two goals of regulatory intervention. Instead they reflect the imbalance of power as they protect the interests of a franchisor over those of a franchisee. The analysis in Chapter Five shows high levels of discretion to a franchisor across many of the contract terms sampled. As one franchise lawyer observed, ‘the “name of the game” here...is the inclusion of appropriate clauses in the Franchise Agreement limiting the potential liability of the Franchisor.’⁶⁰⁷ This contractual assurance of franchisor discretion increases uncertainty for a franchisee and enhances the power of a franchisor at the expense of that of a franchisee.

This chapter also demonstrates that the parties’ self-regulation does not achieve the goals of regulation. Because private regulation through market and contract creates and reinforces imbalance of power and uncertainty, there is a need for direct intervention. This chapter identifies the applicable Code regulation for each contract term, which in most cases involves disclosure. It is despite these statutory measures that the contract terms are characterized by imbalance of power and uncertainty; it is clear that imbalance of power and uncertainty persist in franchising even though direct intervention provides for disclosure to address these conditions.

5.15 CHAPTER SUMMARY AND RECOMMENDATIONS

Chapter Five provides a comparative analysis of eight contract terms from nineteen Australian franchise contracts. The results are consistent with the theoretical analysis of contract in Chapter Four; they indicate that the contract terms reflect an imbalance of power and high levels of uncertainty for a franchisee. The main points and recommendations of this chapter are as follows:

- There is an asymmetry in discretion in franchise contracts. A franchisor enjoys high levels of discretion and power and the greater certainty that come with the exercise of discretion.

⁶⁰⁷ Email from David E. Holmes to ABA Forum on Franchising Listserv, 26 September 2005.

- A franchisor in most cases can make changes unilaterally. Franchisees must comply even if they do not agree. A franchisor can also change operations manual, computer systems, and sometimes control over franchisee premises.
- Case law provides little guidance on the interpretation of these clauses in franchise contracts; this is because Code-mandated mediation means relatively few cases are litigated and because of the complex and idiosyncratic nature of the issues in the cases that are litigated.
- Direct intervention is designed to address private law failure in franchising. Most contract terms are subject to regulatory requirements, predominantly disclosure, that are outlined in each section. Disclosure appears to accomplish little toward improving certainty and balance of power among the parties; even with disclosure, there is a lack of certainty and an imbalance of power in the franchise relationship.

Chapter Six will examine why the current statutory regulation fails to meet its goals, and why, in its current form, it cannot be expected to achieve these goals. It explains why, fundamentally, the Code in its current form cannot be expected to make a difference in redressing balance of power and improving certainty for franchisees.

Chapter Six

Regulation by Direct Intervention:

Why Disclosure Does Not Achieve the Goals of Regulation

‘A curious feature of the growing demand for more information is the paucity of concrete evidence that past disclosures have made a significant difference in consumer or market behaviour.’⁶⁰⁸

6.0 INTRODUCTION

Chapter Five’s results indicated that the terms of the contract continue to reflect the imbalance of power and uncertainty engendered by the market interaction and strengthened by the structure of the contract as standard form and relational. It also indicated that disclosure is the chief method of regulating with respect to these contract terms. Because the problems persist, then, disclosure is not effective in changing the balance of power or uncertainty as reflected in the parties’ contractual commitments.

Here, Chapter Six explains the reasons why, even if it is complied with, the statutory regulation of franchising can fail to achieve its objectives. Because disclosure has a strong self-regulatory element, disclosure does offer cost advantages. In order to ensure efficiency, however, there are conditions that must be met. This chapter evaluates current disclosure in Australia for its consistency with the conditions necessary for effective disclosure. It identifies three persistent problems; first, that there is insufficient information needed both to gauge the risks that regulation should address and to design a regulatory program; second, the disclosure process does not ensure reliability, accessibility and useability of the information; and third, the nature of the relationship and the contracting process impair the capability of prospective franchisees to act on the information.

After identifying problems, this chapter considers some ways to improve the function of disclosure. The lack of information can be addressed by initiatives to develop independent and objective sources of information about the sector and about the risks

⁶⁰⁸ George S. Day, ‘Assessing the Effects of Information Disclosure Requirements’, *Journal of Marketing*, Vol. 40, No. 2 (Apr., 1976) 42-52.

to participants in the sector. The second problem, that the process does not ensure reliability, accessibility and useability of the information, can be addressed through a variety of measures identified in the analysis. The third problem, the fact that franchisees cannot act on the information, is the most difficult to address. It may not be possible for disclosure to improve a prospective franchisee's negotiating position; to render the contract terms more negotiable; to expand the alternatives for contract terms; to make franchises more 'substitutable' for prospective franchisees; or to change the levels of discretion enjoyed by franchisors in managing franchise systems. It may be necessary therefore to consider other regulatory tools to supplement disclosure.

6.1 DISCLOSURE AS A PRINCIPAL REGULATORY TOOL

As has been outlined above in Chapter Two, the Regulatory Impact Statement for the Franchising Code of Conduct lists several 'objectives of government action' including redressing the imbalance of power and increasing certainty for participants.⁶⁰⁹ To achieve these objectives, the Code relies primarily on regulatory tools that include a handful of substantive provisions, prescribed dispute resolution procedures, and information disclosure.⁶¹⁰ Mediation and the few substantive provisions of the Code can help to ameliorate some of the problems that regulation of franchising is meant to address, including the imbalance of power and uncertainty in the relationship. But these measures have limits.

Mediation is a self-regulatory option primarily intended to address problems with dispute resolution. A well-designed dispute resolution process that includes mediation can have benefits. Because the parties are in a continuing relationship, mediation may do less damage to the relationship and improve the parties' capacity to resolve future disputes. Mediation can accommodate parties' needs for privacy and confidentiality. It is often the process of choice in the case of complex, protracted subject matter, or if the subject matter is related to large numbers of other disputes that can benefit from integrative solutions. When issues other than legal issues need to be resolved, mediation can address them. Finally, because of the nature of the process, including

⁶⁰⁹ Explanatory Memorandum, Trade Practices (Industry Codes - Franchising) Regulations 1998 (Cth) No. 162 at

<<http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrument1.nsf/framelodgmentattachments/77630AD9222B25BCCA256F73000E7654>> at 10 April 2005.

⁶¹⁰ *Franchising Code of Conduct 1998* (Cth).

the involvement of the parties themselves throughout mediation, there is greater flexibility in crafting solutions.⁶¹¹ Despite these advantages, however, mediation can also reinforce existing imbalances in the franchise relationship. Where there is a significant power imbalance between the parties, there is a risk that the stronger participant will dominate the process.⁶¹² Also, there is insufficient emphasis on preparation for mediation, which disadvantages the less well-informed and less experienced party, usually a franchisee.⁶¹³ Mediation can occur too late in the relationship; mediation as it is prescribed by the Code primarily deals with conflicts that have risen to the point where parties are seeking outside advice. Mediation does not change the parties' reference to rights and obligations under the contract, which reinforces imbalance of power and uncertainty for a franchisee. Finally, Code-mandated mediation lacks procedures for collective action by franchisees. A franchisor knows the disposition of each prior or related dispute, but each individual franchisee is disadvantaged by lack of knowledge of how similar disputes may have been handled. All these factors mean that mediation can embody and reinforce the imbalance of power and uncertainty that regulation is intended to remedy.

The substantive provisions of the Code also do little to address imbalance of power and uncertainty, with the exception of some aspects of the transfer and termination provisions, most of which involve procedural requirements with respect to notice periods. The prohibition against general indemnity of a franchisor by a franchisee can

⁶¹¹ Boule and Nesic, *Mediation: Principles Process Practice* (2001) at 92-97.

⁶¹² A 1992 study that examined franchisors' choice of dispute resolution strategies showed that when the stakes, franchisee dependence, and complexity of disputes are high, or where there is a high precedent-setting aspect to the dispute, dominant parties choose what they perceive to be low-risk (not necessarily lower cost) strategies such as politics or bargaining. These choices are motivated by perceived immediate gain as well as greater latitude for tactical manoeuvres and exercise of influence. Conversely, when the stakes, franchisee dependence, and complexity of the disputes are perceived to be low, and when the precedent-setting value is low, dominant parties are more likely to choose "higher-risk" processes such as problem-solving and integrative procedures. These results are consistent with two commonly held views about choice of procedure, one, that integrative problem-solving is appropriate when the relative power of the parties is balanced and, two, that rights-based processes are used when there is a need to set precedent. On the other hand, the results of the study challenge the view that integrative problem-solving is more appropriate when levels of complexity are high. They found that the dominant party opted for lower-risk strategies such as politics and bargaining in complex situations. Further research into the organisational culture of franchising may indicate ways to address this aspect of the relational imbalance. See Dant and Schul, 'Conflict Resolution Processes in Contractual Channels of Distribution', (1992) 56 *Journal of Marketing* 1 at 40.

⁶¹³ National Alternative Dispute Resolution Advisory Council (NADRAC) Review of the Franchising Code of Conduct, 9 October 2002. The NADRAC Report suggests that more help should be provided to the parties at this stage. The Report is available at <http://www.nadrac.gov.au/wwwwithdisputeresolutionHome.nsf/Web+Pages/4C00DE78CBE68246CA256B4C0006506D?OpenDocument> at 2 October 2004.

be avoided by careful drafting; rather than a general indemnity the contract simply contains a long list of specific indemnifications of a franchisor by a franchisee.

Because mediation and the few substantive provisions make only minimal contributions toward addressing these two fundamental goals of regulation, and because disclosure is used to regulate eight out of ten of the contract terms sampled, and is the only regulation for six of those terms, disclosure will be considered here in some detail.

Disclosure is a form of informational regulation; it influences the flow of information in a market.⁶¹⁴ Disclosure is often favoured as a cost-efficient alternative to conventional regulatory approaches, and has been a popular regulatory strategy in the US since its introduction in securities regulation in the 1930s.⁶¹⁵ The purpose of informational regulation underlying the securities rules has been to reveal risks to investors so that they can decide whether to invest. Informational regulation is now not only used to protect investors, but also consumers; notable examples are for insurance and home mortgage products. It has also been used in environmental regulation to equip the public with information about the activities of companies and their potential risks to local communities.⁶¹⁶

Today, disclosure is the principal tool in the regulation of the franchise sector in Australia through the Franchising Code of Conduct (the Code). Disclosure is also the principal regulatory tool in many other jurisdictions that have instituted sector-specific regulation of franchising. Of the approximately 25 countries with sector-specific regulation of franchising twelve countries (Australia, Brazil, Canada, France, Indonesia, Italy, Japan, Korea, Mexico, Romania, Spain, and the US) rely on disclosure as the principal means of regulation, as do seventeen US states and a handful of Canadian provinces.⁶¹⁷ Though they have not enacted sector-specific

⁶¹⁴ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 121.

⁶¹⁵ Case, David W., *The Law and Economics of Environmental Information as Regulation*, 31 ELR 10773, (2001) Environmental Law Institute, Washington, DC, <<http://www.vanderbilt.edu/vcems/papers/ELRVersion2.pdf>> at 9 May 2006.

⁶¹⁶ See Susanna Kim Ripken, 'The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation' (2006) 58 *Baylor Law Review* 139.

⁶¹⁷ In the US the UFOC applies in all fifty states and is intended to provide a minimum protection. In addition fourteen states have adopted further legislation requiring disclosure.

legislation, New Zealand and Sweden have voluntary codes that require disclosure.⁶¹⁸ Disclosure is also the central regulatory tool of the International Institute for the Unification of Private Law (UNIDROIT) Model Franchise Disclosure Law.⁶¹⁹

The emphasis on disclosure in franchise regulation seems logical when one considers that misinformation is a major source of conflict in the sector. As Chapter Three described, franchisees often entertain fundamental misperceptions about franchising; they need information and education in order to properly understand the nature of the business structure and the franchise relationship. Accurate, reliable information is not easy to obtain, however, and so regulation aims to make it available through disclosure requirements.

Generally, disclosure works by allowing the recipients of the disclosed information to make use of that information in two ways, to negotiate and/or to find alternatives. First, informational regulation facilitates private bargaining.⁶²⁰ By reducing information asymmetries, and with them the transaction costs which impede effective bargaining, disclosure is thought to improve the transparency and efficiency of markets, and to reduce market volatility.⁶²¹ Second, disclosed information helps recipients to make better-informed choices among the alternatives in the market. By providing market participants equal access to information, disclosure can ‘level the playing field’ and so promote trust and boost confidence in the market.

Levels of regulatory intervention range from low-intervention to high-intervention.⁶²² As a low-intervention tool, where recipients of disclosed information remain responsible for their decisions, disclosure reduces costs to the regulator, ‘in both monitoring and enforcement, in contrast to the “more bureaucratic procedures”

⁶¹⁸ See <<http://www.unidroit.org>> at 3 March 2006.

⁶¹⁹ *Model Franchise Disclosure Law* (2002) UNIDROIT <<http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>> at 5 December 2006.

⁶²⁰ David W. Case, ‘The Law and Economics of Environmental Information as Regulation’ (2001) 31 *Environmental Law Reporter* 10773, <<http://www.vanderbilt.edu/vcems/papers/ELRVersion2.pdf>> at 28 December 2006.

⁶²¹ See Susanna Kim Ripken, ‘The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation’ (2006) 58 *Baylor Law Review* 139, 151-157.

⁶²² Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 5.

associated with traditional regulatory models.⁶²³ Another benefit of the self-regulatory qualities of disclosure is the reduction of guesswork and mistakes by the regulator. Disclosure may also help to avoid the appearance of paternalistic approaches to regulating, a criticism commonly levelled at substantive regulation. The attractiveness of disclosure, then, is due largely to its self-enforcing qualities which are seen to offer an effective, low-intervention and cost-efficient alternative to conventional regulatory approaches in facilitating the efficient operation of markets.⁶²⁴

6.2 CONDITIONS FOR EFFECTIVE DISCLOSURE

Despite its advantages, however, informational regulation is not always the ideal regulatory strategy,

‘Uniformity in modes of regulation and governance is now widely debated. The predominant thesis is that there should be a superior model promoting optimality by disclosure of information and transparency. But today, this thesis is greatly contested...evidence shows that this unique model of regulation and governance tends to generate major failures and turbulences.’⁶²⁵

Disclosure is no longer seen as a panacea. In his analysis of environmental informational regulation David Case has observed that it has been, ‘at best, a blunt and unfocused instrument.’⁶²⁶ Perhaps the problems with disclosure in franchising arise not because it is the wrong tool, but because it needs refinement in application. It is becoming recognized that disclosure has the capacity to generate problems, for example, if it provides inaccurate or incomplete information; fails to identify actual, existing concerns; promotes unjustified fears; produces a false sense of security; perpetuates misinformation; and/or promotes under or over-reaction.⁶²⁷ It has even

⁶²³ David W. Case, ‘The Law and Economics of Environmental Information as Regulation’ (2001) 31 *Environmental Law Reporter* 10773, <<http://www.vanderbilt.edu/vcems/papers/ELRVersion2.pdf>> at 28 December 2006.

⁶²⁴ Ibid.

⁶²⁵ *Third Meeting of the European Network on Economics and the Firm* (2006) European Network on Economics and the Firm <www.enef.group.shef.ac.uk/ENEF%202006%20call.doc> at 8 August 2006.

⁶²⁶ David W. Case, ‘The Law and Economics of Environmental Information as Regulation’ (2001) 31 *Environmental Law Reporter* 10773 <<http://www.vanderbilt.edu/vcems/papers/ELRVersion2.pdf>> at 28 December 2006.

⁶²⁷ Cass Sunstein, ‘Informational Regulation and Informational Standing: Akins and Beyond’ (1999) 147 *University of Pennsylvania Law Review* 613. Failures of disclosure may also occur where the object of regulation is technically complex, rendering concise and accurate disclosure difficult or impossible.

been suggested that disclosure has been counter-productive in the regulation of franchising, ‘The regulatory bodies in their haste to enforce disclosure laws have hurt the very consumer they purport to be protecting.’⁶²⁸

Not only are its disadvantages often underestimated, but also disclosure’s advantages may not be as great as they seem. Though it is relatively low-cost from the point of view of the regulator, there can be significant costs to participants. The preparation of the disclosure document is a major undertaking for franchisors that incurs significant costs. The Review of the Franchising Code of Conduct found that the range of estimated costs per year was \$2,000-\$65,000. The FCA submission to the Review reported an average annual cost per system of \$52,000.⁶²⁹ Franchisors are able to pass these costs on to franchisees, but what is not known is whether the benefits are worth the costs.

While a cost-benefit analysis is beyond the scope of this dissertation, it is possible to consider the appropriateness of this regulatory tool for franchising based on certain conditions that correlate with the optimal effectiveness of disclosure. Sunstein notes that because informational regulation relies on, ‘market pressures...and public pressure to enforce...standards’, it depends on the availability of reliable and ‘useable’ information. Informational regulation can only be effective if recipients have the ability to understand and use the information; also there must be alternatives in the market.⁶³⁰

In his research in the area of environmental regulation, Tietenberg identified four separate ‘functions’ as necessary for the establishment of an effective information disclosure strategy. According to his research, for informational regulation to be effective it is necessary to:

- 1) Gauge the extent and magnitude of the particular risks;
- 2) Obtain reliable information;

⁶²⁸ Email from Lance Winslow, ‘Lance@carwashguys.com’, Date: 19 Jun 2005, posted on <http://www.franchising.org/_bbs/000000bf.htm> at 28 July 2006.

⁶²⁹ Office of Small Business, *Review of the Franchising Code of Conduct: Report of the Franchising Policy Council* (May, 2000) at 47, <<http://www.industry.gov.au/assets/documents/itrinternet/ReviewofFCoC.pdf>> at 1 April 2007.

⁶³⁰ Cass Sunstein, ‘Informational Regulation and Informational Standing: Akins and Beyond’ (1999) 147 *University of Pennsylvania Law Review* 613, 618.

- 3) Disseminate information in a form that is both useable by and accessible to the community; and
- 4) Ensure options for the target audience to act upon the information. Disclosed information might work effectively through pre-existing channels, including market interactions, and/or new mechanisms might be employed, including enforcement.⁶³¹

These ‘functions’ of an effective disclosure strategy suggest a framework for evaluating the effectiveness of disclosure in regulating the franchise sector. For the purposes of this analysis the second and third of these four functions are discussed together, so that they are collapsed into a framework of three conditions for effective disclosure. First, if informational regulation does not gauge the extent and magnitude of the risks, it cannot be designed to address these risks. Second, if it fails to ensure that reliable information is obtained and disseminated in an accessible and useable form, then franchisees as recipients of the information cannot rely upon or access or use the information. Third, if it does not ensure that recipients can act upon the information, then no matter how reliable, accessible and useable the information may be, it is ineffective. Because there is a transaction cost for the recipient to assimilate and use the information, if it does not meet these conditions, disclosure can even be counter-productive.⁶³²

This dissertation evaluates the current disclosure requirements of the Code against the conditions for effective informational regulation. The results indicate that there is insufficient information to properly gauge the risks; that disclosure does not provide all the needed information in a way in which reliability, accessibility and useability are assured, and that franchisees are not fully capable of acting on the disclosed information.

6.3 GAUGING THE RISKS

The first function of effective informational regulation is to ensure that the necessary information is available in order to gauge the risks that regulation should address. As Chapter Three explained, there are several fundamental reasons for the lack of reliable

⁶³¹ Tom Tietenberg, ‘Disclosure Strategies for Pollution Control’ (1998) 11 *Environmental and Resource Economics* 587.

⁶³² Hugh Collins, *Regulating Contracts* (1999) 284-5. See also Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 121-149.

and accurate information about franchising. First, the sources of information about problems in the sector are limited and are dominated by franchisors. Second, franchisors have a strong interest in projecting a positive image of the sector. Third, conflicts of interest between franchisors and franchisees mean less information sharing. Fourth, franchisees who may consider speaking out about their negative experiences in franchising have legitimate concerns about the threat of defamation actions. Fifth, it is difficult to garner evidence from dispute resolution processes.

The lack of reliable information about the sector generally means that the first function of effective informational regulation cannot be adequately carried out, and that all further efforts to tailor a regulatory program to the needs of the sector are compromised. Reliable information informs deliberations and decisions about the design and structure of regulatory process as a whole. It also informs decisions about the use of tools and strategies in regulating. The Preamble to the UNIDROIT Model Franchise Disclosure Law offers a long list of factors that legislators need to consider before instituting informational regulation,

‘whether it is clear that there is a problem, what its nature is, and what action, if any, is necessary; whether prospective investors are more likely to protect themselves against fraud if they have access to truthful, important information in advance of their assent to any franchise agreement; whether the nation’s economic and social interests are best served by legally requiring a balance of information between the parties to a franchise agreement; whether there is a pattern of abusive conduct, or whether this conduct is isolated or limited to particular industries; the nature of the evidence of abuse; whether existing laws address the concerns and whether they are adequately applied; whether an effective system of self-regulation exists; the financial burden the new legislation will place upon franchisors and investors as compared to the benefits of legally required disclosure; whether the proposed legislation inhibits or facilitates entry to franchisors, and its effect on job-creation and investment; and the views of interested organisations, including national franchise associations’.⁶³³

All these considerations inform the determination that disclosure is the right tool for the intended purpose. Information is needed to determine the risks and the purpose of regulatory intervention. Current formulations of disclosure are intended not just to protect franchisees, but also to limit franchisor liability. The Explanatory Note to the UNIDROIT Model Franchise Disclosure Law states that helping franchisees make

⁶³³ *Model Franchise Disclosure Law* (2002) UNIDROIT
<<http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>> at 5 December 2006.

informed investment decisions and providing certainty for franchisors are both contributing factors in the choice of disclosure as the principal tool of the UNIDROIT Model Law:

‘The Model Law is a disclosure law. A disclosure law may be considered to be a means to create a secure legal environment between all the parties in a franchise arrangement. To that end, the Model Law ensures that the prospective franchisees who intend to invest in franchising receive material information about franchise offerings, thus permitting them to make an informed investment decision. In addition, the Model Law brings security to franchisors in their relationships with franchisees, administrative authorities and courts.’⁶³⁴

The chairman of the American Association of Franchisees and Dealers (AAFD) has claimed that mandated disclosure was negotiated by franchisors to avoid accusations of fraud, and that the Federal Trade Commission agreed to allow franchisors to provide a disclosure statement to distance themselves from oral representations. It may be, then, that disclosure was originally intended as protection for the industry rather than the consumer.⁶³⁵ Both for the US disclosure law and for UNIDROIT, it seems that at least part of the motivation for the choice of disclosure has been to protect franchisors’ interests. The Australian goals seem to state purposes to protect franchisee interests, but the regulation was originally modelled on US legislation.

Motivation informs the shape of the regulation. Once the purpose of regulation is determined and regulatory tools are chosen, it is then necessary to determine how they should be designed for their express purpose. In the case of disclosure regulatory process involves gauging the risks in order to determine what information should be provided to prospective franchisees and when and how this information should be provided in order to best address these risks. The difficulty is the lack of reliable and objective information about the sector generally. Though franchising is a significant part of the Australian economy, the dearth of reliable information about the sector has been a perennial problem that impedes useful discussion and analysis of the operation of the sector, as well as attempts to regulate it.

⁶³⁴ Ibid.

⁶³⁵ Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 Penn State Law Review 105, 266

6.4 RELIABLE, ACCESSIBLE AND USEABLE INFORMATION

The second function of effective informational regulation is to ensure the availability of information to prospective franchisees to better inform their investment decisions. Disclosure is a self-regulatory tool that puts the onus on the parties themselves, in particular on a franchisee. If disclosure is to work effectively, a franchisee must have access to reliable, accessible and useable information.

6.4.1 Information about franchising generally

The previous section on ‘gauging the risks’ reiterated the discussion in Chapter Three about the obstacles encountered in Australia in obtaining reliable information about the Australian franchise sector generally. Franchising is the subject of ongoing study in the fields of management, marketing, economics and the law, but there is still much about this business structure that is poorly understood. This is evidenced by the varied conceptions of the nature of the franchise form reflected in academic research, court decisions, and regulatory approaches. If marketing experts, economists, courts, regulators, and lawyers have difficulty in defining franchising, it is understandable that prospective franchisees should entertain misperceptions about the nature of this complex and multi-faceted relationship.

As Chapter Three also explained, misguided franchisee motivations can lead to conflict. The irony is that, even with disclosure, the myths persist; misleading or deceptive conduct is still the most commonly litigated complaint in franchising. Even with disclosure the need for accurate and reliable information persists.

A franchisee needs balanced and objective information about the franchise relationship generally, the business structure, the nature of the franchising contract, the role of other documents and related agreements. One aspect of the relationship that is not explained to a franchisee is the nature of the franchise contract as a contract that is both standard form and relational. For a franchisee to understand franchising, it would do well to recognize the synergistic effects of the contract characteristics, because the combined effect of these qualities has some potentially important and fundamental disadvantages to a franchisee.

Many other aspects of the franchising relationship generally are insufficiently understood. More research is needed about the reasons for franchisees to participate in this business form and the risks involved. Blair and Lafontaine observe that, ‘In an

economic sense, we know that franchising must be efficient as an organizational form since it continues to thrive in competition with other organizational structures.’ But they also point out that ‘there are many ways in which franchisor and franchisee needs diverge’, creating ‘conflict that undermines the value that cooperation creates.’

Independently of each other, the standard form and relational qualities of the contract contribute to imbalance of power and uncertainty in the relationship. As Chapter Four explained, the power imbalance of the standard form combined with the reliance on trust and reciprocity of relational contracting lead to increased inequality of bargaining power. The standard form contract assumes aspects of a ‘commodity’, part of the product a franchisor is selling. This conflicts with the ‘contract as relationship’ of the relational quality of the franchise. To accommodate the relational nature of the contract, all flexibility and discretion is accorded to a franchisor. A franchisee takes on qualities of consumer of product, rather than an equal party to the negotiation of terms. A franchisor has power, while a franchisee must rely on trust, reputation and other factors outside the contract. Further, the lack of negotiation of the contract of the standard form combined with the flexibility, discretion, and vaguely defined obligation required by the relational quality of the franchise contract mean that a franchisor can manage risk through contract, but a franchisee cannot. A franchisor accords flexibility to itself, with specified obligations imposed upon franchisee. Thus, uncertainty for a franchisee is increased. A franchisee should understand how the contract sets up the conditions of imbalance of power and uncertainty in the relationship, conditions that regulatory intervention sets as stated goals to redress. This is information that is not disclosed in any way to a prospective franchisee.

6.4.2 Information about a particular franchise system

In addition to an understanding of franchising generally, a prospective franchisee needs information about a particular franchise system in which it may choose to participate and invest. Disclosure is intended to help franchisees make informed decisions about whether to buy the rights to participate in a particular franchise system. While disclosure purports to provide a franchisee with the necessary information about the nature of the investment and business commitment, however, all the information that is most needed is not always provided. Table 6.1 summarizes

the disclosure requirements of the Code with comments on the relationship of the disclosure requirements to the contract and the utility of these provisions.

Table 6.1: Detail of Disclosure Requirements under the Code

Item #	Information Required to be Disclosed	Information contained in contract term or new information required? Related Contract Term, if any.	Comments
1	If this is a new franchise agreement (not a renewal, extension or transfer) of an agreement, you will be entitled to a 7 day ‘cooling off’ period after signing the agreement, during which you may terminate the agreement without cost.	No related contract term	There may be non-refundable investment, for example, establishment costs, leasing, fit-out made before the signing of the contract (see Item 13). Cooling off will not provide any recourse to the franchisee with respect to these expenditures.
2	Details of a franchisor Name, ABN, ACN or ARBN, address of registered office and principal place of business, description of the kind of business operated under the franchise, name, ABN, ACN or ARBN, address of registered office and principal place of business of each associate of a franchisor; name, position held and qualifications of each director, secretary, executive officer, or partner of a franchisor likely to have management responsibilities	Mostly information not contained in the contract. No related contract term	This information should include all related businesses.
3	Business experience Relevant business experience in the last 10 years of each person, other than an executive officer, mentioned in item 2.6. and of a franchisor (a) length of experience in: (i) operating a business substantially the same as that of the franchise; and (ii) offering other franchises that are substantially the same as the franchise; and (b) whether a franchisor has offered franchises for other businesses and, if so: (i) a description of each such business; and (ii) for how long a franchisor offered franchises for each such business	New information No related contract term	
4	Litigation Details of: (a) current proceedings by a public agency,	New information	Information on current proceedings and past convictions omits

	<p>criminal or civil proceedings or arbitration, relevant to the franchise, against a franchisor in Australia alleging:</p> <p>(i) breach of a franchise agreement; or (ii) contravention of trade practices law; or (iii) contravention of the Corporations Law; or (iv) unconscionable conduct; or (v) misconduct; or</p> <p>(vi) an offence of dishonesty; and</p> <p>(b) proceedings against a franchisor under:</p> <p>(i) section 127A or 127B of the Workplace Relations Act 1996; or (ii) section 106 of the Industrial Relations Act 1996 of New South Wales; or (iii) section 276 of the Industrial Relations Act 1999 of Queensland.</p> <p>4.2 Whether a franchisor or a director of a franchisor has been: (a) in the last 10 years — convicted of a serious offence, or an equivalent offence outside Australia; or (b) in the last 5 years — subject to final judgment in civil proceedings for a matter mentioned in paragraph 4.1 (a); or (c) in the last 10 years — bankrupt, insolvent under administration or an externally-administered body corporate in Australia or elsewhere. Include the following details (where relevant):</p> <p>(a) the names of the parties to the proceedings; (b) the name of the court, tribunal or arbitrator; (c) the case number; (d) the general nature of the proceedings; (e) the current status of the proceedings; (f) the date of order or undertaking under section 87B of the Act; (g) the penalty or damages assessed or imposed; (h) the names of the persons who are bankrupt, insolvent under administration or externally administered; (i) the period of the bankruptcy, insolvency under administration or external administration.</p>	No related contract term	actions that did not result in conviction in last 10 years or judgments in last 5 years. Also does not include information on mediation, though this is the Code-mandated dispute resolution procedure
5	<p>Payments made to recruiting agents</p> <p>For any agreement under which a franchisor must pay an amount, or give other valuable consideration, to a person who is not an officer, director or employee of a franchisor in connection with the introduction or recruitment of a franchisee — the name of the person.</p>	<p>New information</p> <p>No related contract term</p>	No information given on the scope of the relationship
6	<p>Existing franchises and those terminated by a franchisor in the last three years</p> <p>Number, sorted by State, Territory or region, of:</p> <p>(a) existing franchised businesses; and (b)</p>	<p>New information</p> <p>No related contract term</p>	Only the number of former franchisees is provided - no names, addresses or contact information or any

	<p>existing franchisees; and (c) businesses owned or operated by a franchisor in Australia that are substantially the same as the franchise.</p> <p>6.2 For each existing franchisee: (a) business address, if this is not a franchisee’s residential address; and (b) business phone number; and (c) year when a franchisee started operating the franchised business.</p> <p>6.3 However, if there are more than 50 franchises, a franchisor may instead give details for all franchisees in the State, region or metropolitan area in which the franchise is to be operated.</p> <p>6.4 For each of the last 3 financial years and for each of the following events — the number of franchised businesses for which the event happened: (a) the franchise was transferred; (b) the franchised business ceased to operate; (c) the franchise agreement was terminated by a franchisor; (d) the franchise agreement was terminated by a franchisee; (e) the franchise agreement was not renewed when it expired; (f) the franchised business was bought back by a franchisor; (g) the franchise agreement was terminated and the franchised business was acquired by a franchisor.</p>		<p>basis upon which to obtain further information</p>
<p>7</p>	<p>Details of trademark, patent, design or copyright For any trade mark used to identify, and for any patent, design or copyright that is material to, the franchise system (intellectual property): (a) description of the intellectual property; and (b) details of a franchisee’s rights and obligations in connection with the use of the intellectual property; and (c) whether the intellectual property is registered in Australia, and if so, the registration date, registration number and place of registration; and (d) any judgment or pending proceedings that could significantly affect ownership or use of the intellectual property, including: (i) name of court or tribunal; and (ii) matter number; and (iii) summary of the claim or judgment; and (e) if the intellectual property is not owned by a franchisor — who owns it; and (f) details of any agreement that significantly affects a franchisor’s rights to use, or to give others the right to use, the intellectual property,</p>	<p>Most not contained in contract.</p> <p>Intellectual Property Goodwill</p>	<p>Note that 7.2 provides that a franchisor is taken to comply with item 7.1 for any information that is confidential if a franchisor gives: (a) a general description of the subject matter; and (b) a summary of conditions for use by a franchisee.</p>

	including: (i) parties to the agreement; and (ii) nature and extent of any limitation; and (iii) duration of the agreement; and (iv) conditions under which the agreement may be terminated.		
8	Site or Territory Details of the franchise territory including:		
	whether the franchise is for an exclusive or non-exclusive territory or limited to a particular site;	May be in contract term Scope of Grant	
	whether a franchisor or its associates may operate a business that is substantially the same as the franchise in the franchised territory;	May be in contract term Scope of Grant	
	whether a franchisor or its associates may establish other franchises that are substantially the same as the franchise in the franchised territory;	May be in contract term Scope of Grant	
	whether you may operate a business that is substantially the same as your franchise outside the franchised territory; and	May be in contract term Scope of Grant	
	whether a franchisor may change the territory.	May be in contract term Scope of Grant	
9	Supply of Goods or Services to Franchisee Details of: (a) any requirement for a franchisee to maintain a level of inventory or acquire an amount of goods or services; and (b) restrictions on acquisition of goods or services by a franchisee from other sources; and (c) ownership by a franchisor or an associate of a franchisor of an interest in any supplier from which a franchisee may be required to acquire goods or services; and (d) the obligation of a franchisee to accept goods or services from a franchisor, or from an associate of a franchisor; and (e) a franchisor's obligation to supply goods or services to a franchisee; and (f) whether a franchisee will be offered the right to be supplied with the whole range of the goods or services of the franchise; and (g) conditions under which a franchisee can return goods, and to whom; and (h) conditions under which a franchisee can obtain a refund for services provided by a franchisor, and from whom; and (i) whether a franchisor may change the range of goods or services, and if so, to	May be in contract. Operations Manual Products and Supplies	Note that restrictions on the supply of goods may be authorized by the ACCC or permitted on the basis of a notification process.

	<p>what extent; and</p> <p>(j) whether a franchisor, or an associate of a franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, and whether any rebate or financial benefit is shared, directly or indirectly, with franchisees.</p>		
10	<p>Supply of Goods or Services by Franchisee Details of: (a) restrictions on the goods or services that a franchisee may supply; and (b) restrictions on the persons to whom a franchisee may supply goods or services; and (c) whether a franchisee must supply the whole range of the goods or services of the franchise.</p>		Note that restrictions on the supply of goods may be authorized by the ACCC or permitted on the basis of a notification process.
11	<p>Sites or Territories The policy of a franchisor, or an associate of a franchisor, for selection of as many of the following as are relevant: (a) the site to be occupied by the franchised business; (b) the territory in which the franchised business is to operate.</p> <p>11.2 Details of whether the territory or site to be franchised has been subject to a franchised business operated by a previous franchise granted by a franchisor and, if so, details of the franchised business, including the circumstances in which the previous franchisee ceased to operate.</p>	<p>New information</p> <p>No related contract term</p>	<p>11.3 provides that the details mentioned in item 11.2 may be in a separate document and may be made available for inspection at a time and place mentioned in the disclosure document. Effectively, this means that a franchisee must make a special appointment to see such information at franchisor's place of business or other location as designated by a franchisor. This information about the history of the performance of the franchise location or territory is of utmost importance and should not be made more difficult to access by requiring the prospective franchisee to take these extra steps, steps which a franchisor may in a variety of ways discourage a franchisee from taking.</p>
12	<p>Marketing & other co-operative funds For each marketing or other cooperative fund, controlled or administered by or for a</p>	<p>May be in contract.</p>	<p>See also Reg 17</p> <p>In addition to (b) franchisee needs to be</p>

	<p>franchisor, to which a franchisee may be required to contribute, the following details:</p> <p>(a) the kinds of persons who contribute to the fund (for example, franchisee, franchisor, outside supplier);</p> <p>(b) whether a franchisor must contribute to the fund in relation to businesses owned or operated by a franchisor that are substantially the same as the franchised business</p> <p>and, if so, whether the contribution is worked out in the same way as for a franchisee;</p> <p>(c) how much a franchisee must contribute to the fund and whether other franchisees must contribute at a different rate;</p> <p>(d) who controls or administers the fund;</p> <p>(e) whether the fund is audited and, if so, by whom and when;</p> <p>(f) whether the fund's financial statements can be inspected by, or will be given to, franchisees;</p> <p>(g) the kinds of expense for which the fund may be used;</p> <p>(h) the fund's expenses for the last financial year, including the percentage spent on production, advertising, administration and other stated expenses;</p> <p>(i) whether a franchisor or its associates supply goods or services for which the fund pays and, if so, details of the goods or services;</p> <p>(j) whether a franchisor must spend part of the fund on marketing, advertising or promoting a franchisee's business.</p>	<p>Payments</p>	<p>aware that franchisor marketing for this franchise system may be affected by franchisor's interest in other brand(s)</p> <p>Also note that there is no general requirement that a franchisor promotion must benefit the franchisee</p>
<p>13</p>	<p>Payments</p> <p>Prepayments</p> <p>13.1 If a franchisor requires a payment before the franchise agreement is entered into — why the money is required, how the money is to be applied and who will hold the money.</p> <p>13.2 The conditions under which a payment will be refunded.</p> <p>Establishment costs</p> <p>13.3 Details of the range of costs to start operating the franchised business, based on current practice, for the following matters:</p> <p>(a) real property, including property type, location and building size; (b) equipment, fixtures, other fixed assets, construction, remodelling, leasehold improvements and decorating costs; (c) inventory required to begin operation;</p>	<p>Not usually in contract unless in separate schedule.</p> <p>Payments</p>	<p>For items 13.4 and 13.6, if the amount of the payment cannot easily be worked out — the upper and lower limits of the amount.</p>

	<p>(d) security deposits, utility deposits, business licences, insurance and other prepaid expenses; (e) additional funds, including working capital, required by a franchisee before operations begin; (f) other payments by a franchisee to begin operations.</p> <p>13.4 For item 13.3, the details for each payment must include:</p> <p>(a) description of the payment; and (b) amount of the payment or the formula used to work out the payment; and (c) to whom the payment is made; and(d) when the payment is due; and</p> <p>(e) whether the payment is refundable and, if so, under what conditions.</p> <p>Other payments</p> <p>13.6 For each recurring or isolated payment payable by a franchisee to a franchisor or an associate of a franchisor or to be collected by a franchisor or an associate of a franchisor for another person: (a) description of the payment; and (b) amount of the payment or formula used to work out the payment; and (c) to whom the payment is made; and (d) when the payment is due; and (e) whether the payment is refundable and, if so, under what conditions.</p> <p>13.8 If 2 or more of items 13.1, 13.3 and 13.6 apply to a payment, the information required by those items in relation to that payment need be set out only once.</p>		
14	<p>Financing arrangements 14.1 The material conditions of each financing arrangement that a franchisor, its agent or an associate of a franchisor offers to a franchisee for establishment or operation of the franchised business.</p> <p>14.2 For item 14.1, the material conditions of a financing arrangement include the following:</p> <p>(a) any requirement that a franchisee must provide a minimum amount of unborrowed working capital for the franchised business;</p> <p>(b) any requirement that a franchisee must meet a stated debt to equity ratio in relation to the franchised business.</p>	<p>Not usually in contract unless in separate schedule.</p> <p>No related contract term</p>	
15	<p>Franchisor obligations Summary of the conditions of the franchise agreement that deal with obligations of a franchisor (or references to the relevant conditions of the franchise agreement, if attached), including:</p> <p>(a) an obligation to provide training:</p>	<p>In contract.</p> <p>Item 23 permits franchisor to refer to agreement in lieu of</p>	<p>This is a summary of franchisor obligations in the contract. Terms and disclosure often contain vague language with respect to</p>

	<p>(i) before the franchised business starts; and</p> <p>(ii) during operation of the franchised business; and</p> <p>(b) any obligation that continues after the franchised business ceases to operate</p>	<p>providing this information in disclosure.</p> <p>Marketing and Advertising Training</p>	<p>franchisor obligations to the effect that it will be carried out ‘as a franchisor deems necessary’. (Also reasonableness standards frequently used)</p>
16	<p>Franchisee obligations Summary of the conditions of the franchise agreement that deal with obligations for a franchisee (or references to the relevant conditions of the franchise agreement, if attached) for the following matters:</p> <p>(a) site selection and acquisition; (b) requirements for starting the franchised business; (c) development of the site, premises, vehicles and equipment; (d) training: (i) before the franchised business starts; and (ii) during operation of the franchised business; (e) opening the franchised business;</p> <p>(f) complying with standards or operating manuals (h) warranties and customer service; (i) territorial development and minimum performance criteria; (j) maintenance and appearance of premises, vehicles and equipment; (k) insurance; (l) marketing; (m) indemnities and guarantees; (n) participation requirements for a franchisee or its directors, management or employees; (o) records and reports; (p) inspections and audit.</p>	<p>In contract. Item 23 permits franchisor to refer to agreement in lieu of providing this information in disclosure.</p> <p>Minimum performance criteria</p> <p>Various other contractual provisions (see column to left)</p>	<p>(Note: There is no Disclosure Item 16(g) in the Code)</p>
17	<p>Summary of other conditions of the franchise agreement</p> <p>Summary of the conditions of the franchise agreement that deal with the following matters:</p> <p>(a) term of the franchise agreement;</p> <p>(b) variation;</p> <p>(c) renewal or extension;</p> <p>(d) conditions a franchisee must meet to renew or extend the franchise agreement;</p> <p>(e) termination by a franchisor;</p> <p>(f) termination by a franchisee;</p> <p>(g) a franchisee’s goodwill, if any, on termination or expiry;</p> <p>(h) a franchisee’s obligations when a franchise agreement is terminated, expires or is not renewed;</p> <p>(i) a franchisor’s rights to sell its business;</p> <p>(j) transfer of a franchise;</p> <p>(k) mediation;</p> <p>(l) option or right of first refusal, if any, for</p>	<p>In contract. Item 23 permits franchisor to refer to agreement in lieu of providing this information in disclosure.</p> <p>Length of term and renewal period</p> <p>Advertising and Marketing</p> <p>Obligations on Expiration or</p>	<p>This is a summary of franchisee obligations in the contract. Very lengthy, so that impact of any information disclosed may be lost. For example, one firm’s disclosure template lists items (a) through (s) with item (g) regarding franchisee goodwill if any upon expiry. This is an item of importance that should be clearly explained, not buried in the middle of 19 other terms. Significant items grouped together in this list include a franchisor’s right to sell</p>

	<p>a franchisor to buy the franchised business;</p> <p>(m) a franchisor’s rights, if any, to inspect financial and other records of the franchised business;</p> <p>(n) confidentiality of a franchisee’s records;</p> <p>(o) death or disability of a franchisee or a director or shareholder of a franchisee;</p> <p>(p) details of the operation or establishment of any franchisee representative body, eg Franchise Advisory Council;</p> <p>(q) restrictions on a franchisee’s operation of other businesses during or after the term of the franchise agreement;</p> <p>(r) operations manual;</p> <p>(s) choice of governing law.</p>	<p>Termination</p> <p>Transfer</p> <p>Adjustments</p>	<p>its business, conditions of renewal, variation, restraint of trade and others.</p>
18	<p>Obligation to sign related agreements Summary of any requirements under the franchise agreement for a franchisee or directors, shareholders, beneficiaries, owners or partners of a franchisee to enter into any of the following agreements:</p> <p>(a) a lease, sublease, licence or other agreement under which a franchisee can occupy the premises of the franchised business;</p> <p>(b) a chattel lease or hire purchase agreement;</p> <p>(ba) an agreement under which a franchisee gains ownership of, or is authorised to use, any intellectual property;</p> <p>(c) a security agreement, including a guarantee, mortgage, security deposit, indemnity, loan agreement or obligation to provide a bank guarantee to a third party;</p> <p>(d) a confidentiality agreement;</p> <p>(e) an agreement not to carry on business within an area or for a time after the franchise agreement is terminated.</p>	<p>In contract.</p> <p>Intellectual Property</p> <p>Goodwill</p> <p>Restraint of Trade</p>	
19	<p>Earnings information</p> <p>19.1 Earnings information for the franchise, if it is given, must be based on reasonable grounds.</p> <p>19.2 Earnings information may be given in a separate document attached to the disclosure document.</p> <p>19.3 Earnings information includes information from which historical or future financial details of a franchise can be assessed.</p> <p>19.4 If earnings information is not given — the following statement: A franchisor does not give earnings</p>	<p>No related contract term</p>	<p>Franchisor can opt out by statement that it does not provide earnings information. Yet this information is obviously central to the sale and the decision of the prospective franchisee to purchase. In practice a franchisor can circumvent regulatory requirements and avoid liability for Misleading or</p>

	<p>information about a [insert type of franchise] franchise. Earnings may vary between franchises. A franchisor cannot estimate earnings for a particular franchise.</p> <p>19.5 Earnings information that is a projection or forecast must include the following details:</p> <p>(a) the facts and assumptions on which the projection or forecast is based;</p> <p>(b) the extent of enquiries and research undertaken by a franchisor and any other compiler of the projection or forecast;</p> <p>(c) the period to which the projection or forecast relates;</p> <p>(d) an explanation of the choice of the period covered by the projection or forecast;</p> <p>(e) whether the projection or forecast includes depreciation, salary for a franchisee and the cost of servicing loans;</p> <p>(f) assumptions about interest and tax.</p>		<p>deceptive conduct through the use of third parties that provide such information to a franchisee, but are stated not to be acting as agents of a franchisor.</p> <p>If a franchisor does provide earnings information, it will include language to the effect that a franchisor makes no representation or warranty as to its accuracy or completeness.</p>
20	<p>Financial details</p> <p>A statement as at the end of the last financial year, signed by at least 1 director of a franchisor, whether in its directors' opinion there are reasonable grounds to believe that a franchisor will be able to pay its debts as and when they fall due.</p> <p>20.2 Financial reports for each of the last 2 completed financial years that have been prepared by a franchisor in accordance with sections 295 to 297 of the Corporations Law.</p> <p>20.3 Item 20.2 does not apply if:</p> <p>(a) the statement under item 20.1 is supported by an independent audit provided by a registered company auditor within 12 months after the end of the financial year to which the statement relates; and</p> <p>(b) a copy of the independent audit is provided with the statement under item 20.1.</p>	<p>New information.</p> <p>No related contract term</p>	
21	<p>Updates</p> <p>21.1 Any information given under clause 18 of the code that has changed between the date of the disclosure document and the date the disclosure document is given under the code.</p>	<p>No related contract term</p>	
22	<p>Other relevant disclosure information</p> <p>22.1 Copy of proposed franchise agreement may be attached.</p> <p>22.2 Copy of the code may be attached.</p>	<p>No related contract term</p>	

	22.3 Any other information that: (a) a franchisor wants to give; and (b) does not contradict information required to be given.		
23	Provision for acknowledging your receipt of the disclosure document.	NA No related contract term	
	A franchisor may attach a copy of the franchise agreement to the disclosure document. If the agreement itself discloses matters listed in Items 15, 16 and 17 above, then the disclosure document need only refer to their inclusion in the agreement.	In contract.	

6.4.2.1 Disclosure summary

As Table 6.1 indicates, there are 23 items in Annexure One disclosure, requiring 21 substantive sets of information from a franchisor. The table notes where the information is provided in the contract as opposed to additional information not in the contract. The disclosure document may be provided at a different date from the contract, so it is important that the two documents are consistent. The following contract terms with respect to payments and earnings, site information, supply, and advertising illustrate how disclosure requirements may fail to adequately inform a franchisee:

- *Payments and earnings information:* Payments and earnings information are critical to a franchisee. With respect to earnings information, Disclosure Item 13 provides that a franchisor can simply state that it does not furnish such information. Not only does this leave an observer to wonder on what basis the sale of the business is to be made, but also it raises issues of inconsistency with TPA misleading or deceptive conduct provisions (discussed in more detail at 6.4.3 below). For payments required by a franchisee disclosure can also be inadequate. A franchisor is not required to specify all payment amounts, but is allowed to provide a range, with upper and lower limits. Anecdotal information suggests that franchisors often provide more detailed information about payments in final documents that are presented to a franchisee to sign on the day at closing than was provided as part of the

disclosure process. If disclosed information changes, the original disclosure is not effective in informing a franchisee of the nature of the arrangement.⁶³⁶

- *Site information:* Franchising is a flexible model and there are many ways in which a franchisor can structure the legal aspects of a franchisee's premises occupancy. For example, a franchisor may own the real estate, or it may hold the lease and lease or sub-lease to a franchisee, or a franchisee may lease the property directly from the owner. A franchisee should be aware of how the nature of the tenancy of the franchised premises may affect his or her operation on an ongoing basis and at the end of the franchise relationship.⁶³⁷
- *Intellectual property:* Disclosure requires a franchisor to provide only minimal information about its intellectual property. For any information that is confidential a franchisor is permitted by the legislation to provide (a) a general description of the subject matter; and (b) a summary of conditions for use by a franchisee. Details about the ownership of and control over the intellectual property are significant to a franchisee, but are not required to be disclosed.⁶³⁸
- *Franchisee obligations:* Disclosure is not required to offer information about franchisee obligations other than what is contained in the contract. In fact Item 23 permits a franchisor to refer to the contract in lieu of providing this information in Disclosure Item 17 (Item 23 makes the same provision for franchisor obligations required under Disclosure Item 15). Where it is provided as a separate document, Disclosure Item 17 is simply a summary of franchisee obligations in the contract. As franchisee obligations are usually extensive, it is lengthy so that the impact of any information disclosed may be lost. For example, one solicitor's disclosure boilerplate lists items (a) through

⁶³⁶ Also, where prepayments are made, it is not always clear whether these are refundable if a franchisee decides not to go forward within the seven-day cooling off period. But a recent case interprets the Code to offer significant protections; see *Ketchell v Master of Education Services Pty Ltd* [2007] NSWCA 161 in which the New South Wales Court of Appeal held that a franchising agreement was illegal because it contravened clause 11 (1) of the Franchising Code of Conduct.

⁶³⁷ For more information on the structure of retail tenancies in franchising see Jenny Buchan, 'Who is the franchisee contracting with and does it matter anyway?' 51st ICSB World Conference, 2006, Melbourne, Australia.

⁶³⁸ For more information on the importance of disclosure of information with respect to intellectual property rights, see Jenny Buchan, Submission to the Minister for Small Business on disclosure in the regulation of the franchise sector in Australia (2006).

(s) with item (g) regarding franchisee goodwill, if any, upon expiry. This is just one item of importance that should be clearly explained, rather than lost in the middle of nineteen other terms. Other significant items grouped together in this list include a franchisor's right to sell its business, conditions of renewal, variation, and restraint of trade.

- *Franchisor reputation:* Because of the high levels of control and discretion enjoyed by a franchisor, information about the reputation of a franchisor is important information that a franchisee ought to have in making its decision about buying a franchise. This includes information about past business endeavours, business associates, and financial track record, some of which is provided. Also of critical importance is the nature of a franchisor's management of the system and the relationships within it. Franchisees are likely to be frustrated in learning about this aspect of a franchisor's operation. One reason is that there is no contact information for franchisees who have exited the system. Disclosure Item 6 requires only that a prospective franchisee be informed of the number of franchisees who have exited the system in the past three years. No names, addresses or further information is given. Second, though mediation is the Code-mandated dispute resolution procedure, according to the current disclosure requirements, there is no information about franchisees in mediation. The interests of confidentiality in mediation compromise prospective franchisees' ability to obtain information and to understand the nature of problems in the sector and in that franchise system. While some commercial franchise consultants do collect comparative information about franchise systems to share with their clients, this information is patchy, and may be prohibitively expensive for many franchisees. There has been no successful, centralized effort at gathering data about the reputations of franchisor systems that could be made publicly available. As Gillian Hadfield testified as expert witness to expert witness at the Ontario [Canada] public hearings in 2000,

‘They [government] can support the reputation mechanisms and can do that by supporting the flows of information, by allowing information to flow. It's important for the stories about what franchisors have done and what franchisees have experienced to be out there and available at low cost to potential franchisees, so that they can make judgments about what to do, because that's what provides the check on franchisor behaviour that

will in the end probably be most effective. That's really what makes the reputation mechanism that says, "Look, a franchisor's not going to cheat their franchisees because they won't be able to sell franchises." For that to work, that information has to be flowing. That's what you want franchisors to be doing, is paying attention to that...' ⁶³⁹

The 2006 Review of Disclosure Item 8 recommended that the Code 'be amended to require not just the numbers but also names, location and contact details...' The government's response was that the Code should be amended 'to *allow* franchisors to provide details of names, location and contact details *where consent has been obtained and where that information is available to the franchisor.*'⁶⁴⁰ Italics has been added to highlight that this will be a permissive provision and not a requirement of franchisors, and will only operate where a franchisor has made an effort to keep such information and has sought and obtained consent. All this seems highly unlikely, when providing the information is not in a franchisor's interest in the first place.

6.4.2.2 Providing the needed information where contracts are relational

Relational contracts are not amenable to regulation by disclosure because, as Chapter Four outlined, they reflect the uncertainty of the long term largely through the use of open-ended terms, flexibility and discretion.⁶⁴¹ The relational qualities of flexibility and discretion mean that there are significant aspects of the contractual relationship that are left to be arranged by the parties over time. Because these aspects are not specified, much of the 'deal' remains to be determined and therefore cannot be disclosed. The fact that the terms cannot be disclosed, however, does not mean that a franchisee cannot be apprised of the significance of the discretion left to a franchisor in these unspecified aspects of the contractual arrangement.

⁶³⁹ Gillian K. Hadfield, Expert Testimony , Legislative Assembly of Ontario, March 8, 2000
<http://www.bluemaumau.org/gillian_hadfield_value_reputation_systems> at 9 September 2007.

⁶⁴⁰ See the *Review of the Disclosure Provisions of the Franchising Code of Conduct*, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007 and the Australian Government *Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct*, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

⁶⁴¹ I. Ayres and R. Gertner, 'Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules' (1992) 101 *Yale Law Journal* 729.

6.4.3 Monitoring to ensure reliability

Though informational regulation is largely self-regulatory, the regulator has a continuing role in monitoring the ability of participants in the sector to adequately perform their self-regulatory functions. Just as franchisors collectively have an interest in marketing franchising as a business opportunity, each individual franchisor is in the business of selling franchises and so has an interest in projecting a positive image. The lack of registration or monitoring of disclosure documents increases any franchisor temptation to provide more favourable information than it warranted, or to leave out select details. A franchisor may also minimise the importance of the disclosed information in discussions with a franchisee.

Misleading or deceptive conduct under section 52 of the Trade Practices Act (the TPA) is the most commonly-litigated complaint in franchising,⁶⁴² even though disclosure is the primary regulatory tool of the Code. The Code and TPA section 52 actually conflict with rather than complement each other because the Code allows a franchisor to decline to provide earnings information, while failure to disclose material information can constitute a breach of TPA section 52.⁶⁴³ A franchisor typically protects against the risk of a TPA section 52 breach by requiring a franchisee to sign a deed of representation,⁶⁴⁴ as well as through contractual provisions that may include a merger clause,⁶⁴⁵ and/or a clause that states that the ‘sales representative is not our agent’.⁶⁴⁶ Together these measures form multiple barriers to successful claims by franchisees of misleading or deceptive conduct on the part of a franchisor in

⁶⁴² Some cases litigated on claims of breach of section 52 of the TPA since the adoption of the Code include *Australian Billboard Connections Pty. Ltd v Jansen* [2000] VSC 471, *ACCC v Billbusters* [2003] FCA 423, *ACCC v Will Writers Guild Pty Ltd* (2003) FCA 1231 and *ACCC v Ewing* [2004] 2204 FCA 5. *Bateman v Slatyer* (1987) 71 LAR 553, Fed Ct of Aust (Barbara’s House & Garden), *Borderland Investments Pty Ltd v Theiss Toyota Pty Ltd (now known as Toyota Motor Sales Australia Ltd)* (1987) VG 385, *Crawford & Ors v Parish* (1992) ATPR (Digest) 46-087, *Novamaze v Cut Price Deli* (1995) 128 ALR 540, and *Haynes & Anor v Top Slice Deli Pty Limited & Ors* (1995) ATPR (Digest) 46-147.

⁶⁴³ Earnings information is material information; not even a naïve and inexperienced franchisee would purchase a franchise without formulating some idea of expected earnings.

⁶⁴⁴ The Deed of Representation that many franchisees are now required to sign states in essence that in making the decision to enter the agreement, a franchisee has not relied on any information provided by a franchisor

⁶⁴⁵ Also known as a ‘whole agreement’ or ‘integration clause’, the ‘merger clause’ is a clause that is included in most franchise contracts. The clause states that the writing constitutes the sole and final agreement between the parties.

⁶⁴⁶ See *Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd* [2005] FCAFC 131, aka the Lenard’s case.

recruitment and negotiation.⁶⁴⁷ The result is that franchisees are recipients of information upon which they cannot rely, as ‘...a franchisor may provide a disclosure document in accordance with the Code but be found by a court to have represented or warranted little at all.’⁶⁴⁸ The Code disclosure requirements, when taken together with the risk of misleading or deceptive conduct under TPA section 52, create an incentive for franchisors to disclose required information but to do so in such a way that a franchisee cannot later claim to have relied upon the information. Rather than reinforcing the Code, TPA section 52 may actually diminish the utility of disclosure.

There are also procedural inconsistencies in enforcement of the Code of Conduct and TPA misleading and deceptive conduct provisions. In principle both are enforceable by the parties themselves or by the Australian Competition and Consumer Commission (the ACCC). In practice, as the regulatory agency charged with administering the Trade Practices Act the ACCC administers and enforces mandatory industry codes established pursuant to TPA section 51AD, unless the enabling legislation provides otherwise.⁶⁴⁹ Subject to external review by Courts, Tribunals, Parliament, independent reviews and the Commonwealth Ombudsman, the ACCC handles inquiries on all aspects of the Code; it is responsible for education about and enforcement of the Code, as well as many other federal regulations that affect franchising, such as consumer protection and competition law. The enabling legislation does provide that private parties may also bring an action for breaches of the Code. Other sections dealing with misleading conduct, such as TPA section 59, provide for criminal penalties in case of breach; these would be enforced by the Director of Public Prosecutions (DPP).

It should be noted that there are ways in which the Code and the TPA do support each other. For example, where the Code requires a franchisor to give reasons for termination, if these reasons demonstrate unconscionability, an action will lie under TPA section 51AC. To summarize, however, reliable information that is needed by a franchisee to make disclosure function as it is intended is not always assured or made

⁶⁴⁷ Most recently, the Lenard’s case involved misleading or deceptive conduct under TPA section 52 of the *Trade Practices Act 1974* (Cth) (TPA) and the extent to which the operation of TPA section 52 can be circumvented by disclaimers and “entire agreement” clauses.

⁶⁴⁸ Des Giugni, ‘Standards of Franchising Disclosure: The Disclosure Document’ (1998-99) *Franchising Law and Policy Review* 84.

⁶⁴⁹ Original proposals envisioned a new, separate administrative body to oversee the Code. Such a body was not set up.

available to a franchisee. There is no monitoring, no registration and the Code is not designed so that it is reinforced substantively and procedurally by TPA section 52

6.4.4 Accessibility and useability

Continuing with the requirement that reliable information should be obtained and disseminated in a form that is accessible and useable by a franchisee,⁶⁵⁰ the next section evaluates the regulation of franchising in Australia for the qualities of accessibility and ‘useability’. Accessibility may be compromised by the use of obscure language or ‘legalese’ and discrepancies in legal advice. For several reasons, as discussed in Chapter Four, franchisees often fail to secure adequate legal representation and advice and so they operate at a disadvantage, not only with respect to their understanding of the contract but also disclosure and other documents such as hire-purchase agreements, leases and security agreements. Disclosure documents written by franchisors’ lawyers often employ formalized language that a franchisee is not likely to be able to use if it does not understand. Such language may not be intended to confuse a franchisee,

‘One of the limitations of disclosure is the difficulty of drafting simplistic, understandable descriptions of the structure and operations of business organizations that are today more complex than at any other time in history.’⁶⁵¹

The primary purpose of a solicitor’s drafting of disclosure documents, however, is not to inform a franchisee as a consumer in making a decision, but rather to protect the drafting party, its franchisor client, from liability.⁶⁵²

Other factors that have the potential to detract from franchisees’ ability to access and use information are physical accessibility, presentation and inappropriate timing. In some cases a franchisee must make an appointment to view certain information at a franchisor’s place of business. This is expressly permitted by the Code with respect to critical information about past performance of the particular unit or territory.⁶⁵³

⁶⁵⁰ For the purposes of this paper, liberty has been taken with Tietenberg’s functions two and three, which are here collapsed into one function; a requirement of reliable information disseminated an accessible and useable form.

⁶⁵¹ Susanna Kim Ripken, ‘The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation’ (2006) 58 *Baylor Law Review* 139, 148.

⁶⁵² *Id.*, 186.

⁶⁵³ Franchising Code of Conduct, Disclosure Item 11.

Timing in the provision of information is another difficult issue; information may be provided too early to engage a franchisee or it may come too late, when a franchisee feels committed and has made specific investments and when confirmation bias prevents a franchisee from making use of the information. Most jurisdictions that require disclosure specify a time period to allow a franchisee reasonable time to review the information, typically from seven to twenty days.⁶⁵⁴ The recruitment process, however, can take months. There can be a considerable amount of time and psychological investment in the deal by the time disclosure is introduced.⁶⁵⁵

Franchisee inexperience and state of mind can further impair the ‘useability’ of the disclosed information. Prospective franchisees often lack the sophistication and awareness necessary to properly assimilate and benefit from the information disclosed, particularly as many are inexperienced in business.⁶⁵⁶ Most franchisees have never signed or even seen a franchise contract before. Their lack of skills to decipher what the information means or how to use it effectively can have debilitating consequences when franchisees are faced with large amounts of information. Lengthy and complex disclosure may impede rather than facilitate decision-making.

Further limits to franchisees’ ability to use information include psychological factors such as optimism and overconfidence. Studies show that people often have higher expectations of their own abilities than are justified by objective tests.⁶⁵⁷ A prospective franchisee may look at an underperforming location and be overconfident in his or her ability to overcome obstacles. Studies also show that overconfidence can lead people to believe they have better-than-average abilities to judge character so that they substantially overrate their own capacity to evaluate the trustworthiness of others.⁶⁵⁸ These factors can prevent a franchisee from realistic assessment of its

⁶⁵⁴ The longest, 20 days, is required in France. Brazil requires 10 days, Italy 15 days. US states’ requirements vary. In Australia, the franchise disclosure must be provided 14 days before the contract is signed.

⁶⁵⁵ Accenture presentation conducted at Franchise Council of Australia Conference, Melbourne 2004. Of about 10-11 steps in the recruitment/sales process, contract is introduced in around the third quarter.

⁶⁵⁶ The *Deloitte Franchisee Satisfaction Survey* (2004) Deloitte <http://www.deloitte.com/dtt/press_release/0,1014,sid%253D5527%2526cid%253D83960,00.html> at 15 August 2005.

⁶⁵⁷ Susanna Kim Ripken, ‘The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation’ (2006) 58 *Baylor Law Review* 139, 163-176.

⁶⁵⁸ *Ibid.*

future business partner.⁶⁵⁹ Finally, confirmation bias, the tendency to give greater weight to information that confirms existing opinions, creates a tendency to discount new information, and so prevents a franchisee from effectively using disclosure.⁶⁶⁰

6.4.5 Summary of problems with respect to reliability, accessibility and useability

To summarize, there is a variety of limitations of disclosure with respect to the reliability, accessibility and useability of the disclosed information. First, the information a franchisee needs is not always provided. This includes information about franchising generally as a business form and about the particular franchise system. General information should include information about the nature of the market interaction and the ramifications of the standard form and relational characteristics of contract. Specific information should include information a franchisee needs about payments and earnings, site information, intellectual property, franchisee obligations and franchisor reputation. Other problems with reliability are the lack of monitoring to ensure compliance, and difficulties in enforcement, for example because Code disclosure is inconsistent with misleading or deceptive conduct provisions of the TPA. Accessibility can be compromised by the language of disclosure as well as presentation and timing. ‘Useability’ is impaired because franchisees are often inexperienced and naïve about business practices and are not ‘rational actors’ in their use of the information. For all these reasons the disclosed information is not as reliable, accessible or as useable as possible for optimum effectiveness of disclosure.

6.5 OPTIONS TO ACT

The final function of effective informational regulation is to ensure that the recipient has options to act on the information. This is a major obstacle to the effective operation of informational regulation of franchising. Fundamentally, disclosure works by helping a recipient of information 1) to negotiate and/or 2) to find alternatives in the market. For disclosure in the regulation of franchising to function effectively, then, a franchisee must be able to negotiate and/or to find alternatives.

⁶⁵⁹ This may not be the way that a franchisee should see the role of a franchisor, as the contract states that they are not partners. Many do see it that way, however, in part because that is how the relationship is often marketed by franchisors.

⁶⁶⁰ Susanna Kim Ripken, ‘The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation’ (2006) 58 *Baylor Law Review* 139, 163-176.

The standard form and relational characteristics of a franchise contract detract from the efficacy of disclosure by impairing the ability of a franchisee to act on the disclosed information both to negotiate and to find alternatives.

First, standard form contracting implies an imbalance of negotiating power. In a situation where a franchisor writes the contract and does not allow negotiation of contract terms, a franchisee is unable to act in the negotiation process even if it has the necessary information. Disclosure may have the potential to ‘level the playing field’, but it is less effective if a franchisee cannot use the information to bargain.

Since the standard form forecloses the possibility of negotiation, the main function of disclosure in the franchising context is to enable a franchisee to make alternative selections in the market. Disclosure, however, can be effective in this way only if a franchisee has options. Investors and consumers, for example, can compare what is on offer in the market, and can easily find alternatives. The problem is that there may not be many viable alternatives. First, it may be that a franchisee may not be able to find a substitutable product. As the court found in a US case,

‘[the] unique nature of [the subject of the contract] meant that plaintiffs were not able to go elsewhere and seek different terms.... Where goods and services can only be obtained from one source (or general sources on non-competitive terms) the choices of one who desires to purchase are limited to acceptance of the terms offered or doing without.’⁶⁶¹

A franchisee is likely to find itself in a similar position in buying a franchise. Branding is critical in franchising; because the essence of business format franchising lies in the qualities of that particular brand, the choice of a particular franchise may not be substitutable for a franchisee. Even if it is, standard terms are widely used across the franchise sector, and so there are limited alternatives in the market for contract terms.

It may be also that a franchisee is not able to use disclosure to find alternatives in the market because of the timing of disclosure. Daniel Barnhizer discusses this problem and the court interpretation of the bargaining positions of the parties to a contract,

‘Given the dynamic, changing nature of parties' developing preferences and subjective desires between the initial moment of desire and the execution of a contract, the key to assessing bargaining power on the basis of meaningfulness of alternatives often depends upon the time frame in which the court assesses those desires. ...some courts assess the alternatives available before that party actually decided to enter a contract with the allegedly stronger party. This

⁶⁶¹ 123 California Reporter 2d 288, 294 (Cal. Ct. App. 2002) 293.

approach maximizes the possible alternatives that the allegedly weaker party could have explored rather than accept the proffered terms and generally justifies a conclusion that the apparently weaker party did not lack meaningful alternatives.⁶⁶²

Late disclosure can impair a franchisee's ability to act on the information because it reduces the latitude for substitution of alternatives in the market. Not only is there a considerable amount of time and psychological investment in the deal by the time the contract is introduced, but also there is less latitude for substitution of other products in the market. If disclosure fails to coincide with the time that a franchisee may be comparing alternatives, it cannot help a franchisee with this function. If, in the process of entering franchising, a franchisee does make comparisons, by the time a franchisee receives the disclosure document, it is likely to have passed the stage of comparing franchise systems. At the stage where a franchisee may be comparing different franchise systems, because there is no registration of disclosure documents, a franchisor's disclosure information is not available to help a franchisee to make comparisons.

In addition to the problems raised by the standard form, the relational quality of the contract impairs the ability of a franchisee to use the information. There are two fundamental reasons why a relational contract is not conducive to regulation by disclosure. First, a relational contract emphasizes the 'trust us' aspect of the relationship, and so detracts from the psychological importance of franchisee due diligence. Second, the relational qualities of flexibility and discretion leave significant aspects of the contractual relationship to be arranged by the parties over time. Obviously, since these aspects are not specified they cannot be disclosed at the time of contract formation.

The character of the relationship between franchisor and franchisee varies with the stage of operation of both the individual franchise unit and the system, in addition to external influences. While contract formation, the target of disclosure, is a critical stage, performance of the contract extends over a period of many years. A relational contract is not conducive to regulation by disclosure because the relational quality of the franchise contract is inconsistent with the regulatory focus on formation. As Gillian Hadfield noted, the focus on the unequal bargaining power between franchisor

⁶⁶² Daniel D. Barnhizer, 'Inequality of Bargaining Power' (2005) 76 *University of Colorado Law Review* 139, 204.

and franchisee at the time the contract is "negotiated" fails to address the fact that 'the difficulties in franchising arise in the ongoing exercise of power in the gaps of the incomplete contract.'⁶⁶³

To summarize, the third set of limitations of disclosure as a tool to regulate the franchise sector involves the ability of franchisees to act on the disclosed information. The contract is standard form, and so impairs the use of information to negotiate and to find alternatives. The contract is relational; it emphasizes trust over due diligence; also, it leaves contract terms unspecified, and therefore impossible to disclose.

6.6 ENHANCING DISCLOSURE

6.6.1 Measures to better gauge the risks

There are potential solutions to problems with the insufficiency of information needed to gauge the risks that regulation should address. Several avenues are available to obtaining more meaningful measurements to inform regulatory process generally. These include cooperation with legitimate, independent research initiatives; better information from franchisees and franchisors, through, for example, the use of an intranet; better studies and surveys that accurately reflect all stakeholders' interests; ; fuller representation of stakeholders on consultative panels; and more complete information from dispute processes, especially the Code-mandated process of mediation.

Industry leaders and regulators should encourage more independent research about the sector. In this respect there are some franchising organizations that can serve as models. The European Franchise Federation (the EFF) lists as its objects the coordination of the national organizations, unbiased and scientific study and the dissemination of that information; it outlines in some detail how it approaches its 'scientific, pedagogic, informational and ethical objectives'.⁶⁶⁴ The French Franchise Federation (the FFF) actively supports academic research,⁶⁶⁵ and the FFF and the

⁶⁶³ Gillian Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, n 262.

⁶⁶⁴ Article 3.3 of the Statutes of the Federation (2001) <http://www.eff-franchise.com/EFF%20statutes%20of%20the%20federation_ENG%20version.pdf> at 26 December 2006.

⁶⁶⁵ 'Fédération Française de la Franchise (the FFF), <<http://www.franchise-fff.com>> at 10 March 2007.

American ‘International Franchise Association’ (the IFA)⁶⁶⁶ also actively support the unification of franchisor and franchisee interests, perhaps most importantly by unifying them as members in one association.

One place to look for information about problems in the sector in some countries is on the Internet in the form of chat groups and blogs. There is no resource of this kind for Australian franchisees perhaps due to the risk of defamation. In Canada Gillian Hadfield testified that,

‘...by mandating participation in an Internet Web site that publicizes information about the experience of franchisees with particular franchisors, that prospective franchisees could then access in order to assess, just as they're assessing investment levels and how you've been in this, so that the information is there. At the end of the day, I think that's one of the most effective things we can do.’⁶⁶⁷

6.6.2 Measures to enhance the reliability, accessibility and ‘useability’ of disclosure

Giving a franchisee the right information involves better informing prospective franchisees about the nature of the sector and the nature of the franchising relationship generally, as well as the inherent risks for participants in the sector, particularly for franchisees. A franchisee needs a better understanding of the nature of this business form as it is exemplified in the characteristics of the contractual relationship that is standard form and relational, and the general qualities and characteristics of the contract terms. Such information would help a franchisee in making a decision about whether to purchase a franchise or to operate an independent small business. Further, it could have some influence on which franchise to purchase. If this information is to be provided, it could be through educational initiatives that involve franchisors,

⁶⁶⁶ The International Franchising Association (the IFA) is the primary industry group in the US. The IFA’s new self-regulation program offers an ‘effective alternative to litigation and legislation, both of which are costly, time-consuming and potentially destructive to franchising’. An important aspect is that it integrates franchisors and franchisees within the organization, enabling cooperation among interested parties to find effect solutions apart from litigation and government regulation. Other related initiatives include streamlined enforcement; an ombudsman who, in the case of a dispute serves as the first point of contact; a reward/recognition program; and new educational programs (especially on-line education) to serve the needs of both franchisors and prospect franchisees. See the International Franchise Association, *IFA Self Regulation Program* (2005) International Franchise Association <<http://www.franchise.org/content.asp?contentid=770>> at 31 December 2005.

⁶⁶⁷ Gillian K. Hadfield, Expert Testimony, Legislative Assembly of Ontario, March 8, 2000 <http://www.blumaumau.org/gillian_hadfield_value_reputation_systems> at 9 September 2007.

franchisees and the regulator on an ongoing basis, rather than being limited to the franchisor/franchisee interaction at the time of entering the contract.

Giving a franchisee the right information also raises the issue of the need for the right information to be provided about the particular franchise system. The risks must be identified in order to determine what information a franchisee needs to make its decision. What is needed is a participative process to better determine the nature and extent of the risks to both parties in the relationship and the best ways to address them.

Earnings information should be provided to a franchisee in a way that is consistent with both the Code and TPA section 52. Under TPA section 52, failure to provide material information can constitute misleading or deceptive conduct. If a franchisor still does not disclose earnings information, a franchisee should not simply be required to sign a document to this effect and a Deed of Representation to the effect that a franchisee has not relied. This provides a franchisee with little recourse when earnings do not meet those it has been led to expect through oral representations, inferences and agents' representations. Instead, a franchisee should include a statement of what information it does rely upon in making the decision to purchase the licence.

With respect to payments or any other information that is supposed to be disclosed, if this information is contained in the final contract but not in disclosure documents, this omission amounts to non-compliance with disclosure requirements, and there should be procedures for monitoring and enforcement of the regulation to deter non-compliance.⁶⁶⁸ Site information should include disclosure to a franchisee about the nature of the legal entities involved and what rights these entities hold in a variety of circumstances, including transfer, termination, and franchisor insolvency.⁶⁶⁹

Particular information a franchisee needs about the franchise system also includes information about the reputation of a franchisor. Some of this information can be provided by a franchisor in disclosure, such as the number and nature of mediations in which they have been involved (in addition to the information that already must be

⁶⁶⁸ Personal interview with former Tweed Heads Lenard's franchisee, Samantha Gow, Gold Coast, January 2006.

⁶⁶⁹ For more detailed research on these issues see Jenny Buchan, Submission to the Minister for Small Business on disclosure in the regulation of the franchise sector in Australia (2006).

provided about ongoing litigation) and contact information for franchisees who are, for one reason or another, no longer with the system. Another aspect of this information, however, can only be provided by participants in the market, in particular by franchisees, but also by suppliers, other stakeholders and third parties, for example on the Internet through consumer organizations. Provision of information through the market may require regulator intervention; to the extent it happens commercially, the information will probably not be widely available and will be less available to the prospective franchisees that most need it. As Hadfield testified, it is important that the information be available at low cost to prospective franchisees.⁶⁷⁰

In franchising, because negotiation is not generally available, the principal reason for disclosure of information is to enable a franchisee to find alternatives in the market. Here reputation offers several advantages; it is available early; it can be made widely available; and it can be used for comparison, whereas disclosure is only available relatively late in the decision process and for the one system, so it has less value as a comparative tool.

Reputation including business history, dispute resolution trends, and so on constitutes critical information needed by any prospective franchisee about the franchise. Such information reveals how franchisees see a franchisor and how a franchisor handles relationships and the management of the system. Reputation as a market regulatory instrument to supplement disclosure thus benefits quality franchise systems and the sector. Currently, providing disclosure to individual, prospective franchisees reduces franchisor risk of liability, but is not a source of marketing benefits to a franchisor. This is an important function that can benefit the brand. Market power of corporations rests on established reputation of the brand. Goodwill provides insurance against risks of innovation.⁶⁷¹ By enhancing the importance of reputation in the sales process, a high-quality franchisor stands to gain and where better quality franchisors gain, the image of the sector should improve as well. Thus, improved regulation has the potential to enhance the quality of franchising overall to enhance franchisors' marketing efforts for the sector.

⁶⁷⁰ Gillian K. Hadfield, Expert Testimony , Legislative Assembly of Ontario, March 8, 2000 http://www.blumaumau.org/gillian_hadfield_value_reputation_systems at 9 September 2007.

⁶⁷¹ William van Caenegem, 'Striking a Balance between Protecting Commercial Reputation and Promoting Competition' (2003) 77 *Australian Law Journal* 598.

Monitoring and enforcement of the Code has been a subject of complaint by franchisees.⁶⁷² The 2006 Review of the Disclosure Provisions of the Franchising Code of Conduct found that, ‘The administration of the Code by the ACCC is a key element in ensuring that franchisors are complying with the disclosure provisions of the Code.’ The Review noted, however, that, ‘A number of submissions from franchisees expressed concern about the level and extent of action by the ACCC to deal with claims of breaches of the Code by franchisors.’⁶⁷³ If the Code is to be effective, there must be adequate capacity by the regulator to enforce the Code where necessary.

In France and in the US there are penalties for non-compliance with disclosure. In Australia there are penalties for providing false or misleading information under TPA misleading or deceptive conduct provisions, but, though TPA section 51AD states that a breach of the Code amounts to a breach of the TPA itself, there are no fines prescribed for failure to comply with the Code.⁶⁷⁴ In sum the regulation of franchising in Australia needs more effective and comprehensive enforcement, monitoring and review procedures.

Standardization of procedures regarding measurement and collection methods for disclosed information could help assure disclosure of reliable information. In order to ensure consistency with misleading or deceptive conduct provisions of the Trade Practices Act, some measures to improve operation of regulation in this area would be to harmonize enforcement and interpretation of misleading or deceptive conduct and the Code disclosure; if necessary, revise regulation to extend the coverage of principal legislation; and increase enforcement and monitoring.

Because the language of disclosure in some cases may be confusing, further measures can help to ensure franchisee access to legal advice. If franchisees are to understand

⁶⁷² Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007.

⁶⁷³ See Recommendation 24 of the Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007.

⁶⁷⁴ The penalties for breaching this section include: Injunction under s80 of TPA; and Damages under s82 of TPA (an applicant can claim damages if they can show that they have suffered loss or damage as a result of the respondent breaching s51AD).

the terms of a franchise contract without having to consult with a lawyer, a ‘plain language’ requirement could be included in the legislation.⁶⁷⁵ Franchisors could be required to construct the documents so that they are intelligible to prospective franchisees that may be inexperienced in business and/or lack a legal background.

Educational programs are needed to help franchisees use disclosed information. Education is a critical component of the success of participative processes, and complements disclosure as a regulatory tool.⁶⁷⁶ The focus of regulatory intervention is on the supply side, but the fact that recipients are often inexperienced and naïve about business practices indicates a need for regulation to better address the demand side, that of a franchisee. Another option, then, is a collective effort within a franchisee community to provide education to prospective franchisees. This, however, assumes the existence of a franchisee community, a ‘contracting community’ that currently does not exist.

Further assurances of physical accessibility and proper timing of disclosure can be instituted. The extra step of requiring a franchisee to make an appointment to visit a franchisor’s office or other locations to view disclosed information should be eliminated if it is not justified by a legitimate need to protect confidentiality of information that cannot be ensured through other means such as a franchisee signing a confidentiality agreement upon receipt of disclosure. As previously discussed, it may be beneficial to many franchisees to provide disclosure earlier, possibly through staged disclosure.⁶⁷⁷

Because disclosure does little to enhance a franchisee’s ability to negotiate, there is greater emphasis on disclosure’s other key role, that of increasing a franchisee’s ability to make alternative selections in the market. When it does choose to enter a contract, a franchisee needs education and guidance about the arrangement. Education complements disclosure, so that franchisees are better equipped to understand and to

⁶⁷⁵ Please refer to Chapter Seven’s overview of tools used to regulate the franchise sector in other jurisdictions, but the author is not aware of a plain language requirement in any other jurisdiction at the time of this writing.

⁶⁷⁶ Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998).

⁶⁷⁷ Also, disclosure can be organized to better address specific needs for information. There might be a Part A, General System disclosure; Part B, General disclosure for all operators at each level of the system; Part C, State disclosure with organizational chart; and Part D, Specific Unit disclosure. See Jenny Buchan, Submission to the Minister for Small Business (2006).

act on the information. Currently, disclosure may not protect a franchisee, partly because there is no explanation of the risks involved with particular contract terms. The Franchise Council of Australia (the FCA) website offers some information for prospective franchisees, the Small Business Development Corporation (SBDC) sells books on franchising,⁶⁷⁸ and the Australian Competition and Consumer Commission (the ACCC) offers *A Franchisee's Guide* which explains the application of the Code of Conduct.⁶⁷⁹ It is probably ill-advised to rely on franchisors for this function at this time, but disclosure might safely serve both functions if it were monitored and there was in place a procedure for registration. Much of the information that is needed could be provided through a process of collaboration in educational initiatives that involve franchisors, franchisees and the regulator, and not by the particular prospective franchisor as part of the contracting process. There is a role for the regulator to coordinate collaborative initiatives to improve educational programs by the regulator or associations.⁶⁸⁰

6.6.2.1 Registration of disclosure

Registration of disclosure documents is required in about fourteen US states.⁶⁸¹ Malaysia also requires filing of disclosure documents. Registration of disclosure documents increases transparency in regulatory process, allows the possibility of comparison, and supports a market for terms and other collaborative processes of regulation. It also provides important baseline data about the sector as a whole. In the US, 'Using these documents has generated a volume of highly reliable data unmatched in any prior survey-based studies.'⁶⁸² In Australia such information could prove invaluable in identifying the problems in the sector, formulating regulatory goals, and in selecting the appropriate tools to achieve them.

⁶⁷⁸ See Small Business Development Corporation Online Bookshop <<http://www.sbdc.com.au/bookshop/bookshop.asp>> at 5 December 2006.

⁶⁷⁹ Available on the ACCC website - Australian Competition and Consumer Commission, *A franchisee's guide: a guide to the Franchising Code of Conduct* (2001) Australian Competition and Consumer Commission <<http://www.accc.gov.au/content/index.phtml/itemId/304784>> at 31 December 2005.

⁶⁸⁰ For more on the synergistic effects of education coupled with disclosure see Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (1998).

⁶⁸¹ The Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007.

⁶⁸² *Deacons on Franchise Legislation* (2006) Franchisebusiness.com.au <<http://www.franchisebusiness.com.au/articles/FC/0C0402FC.aspx>> at 10 July 2006.

Registration was recommended by the 2006 the Review of the Disclosure Provisions of the Franchising Code of Conduct. The Review found that,

‘A number of franchisees advised the Committee that they had not been given disclosure documents at all whilst some others advised that the disclosure document they had received was not in accordance with the Code. Additionally many of the concerns raised in the submissions may have been overcome if the degree of compliance with the disclosure provisions of the Code was improved. The Committee formed the view that to address this issue, the registration of franchisors and review of a sample of disclosure documents should be introduced.’⁶⁸³

The government did not agree to carry out this recommendation, stating that,

‘Decisions relating to the viability and associated risks of any business venture are ultimately the decision of the businesses themselves.’ The government also expressed concerns about the burden that registration would place on the regulator,

‘Registration of the franchisors and their disclosure documents could be seen as providing credibility to their claims and ACCC endorsement. The ACCC would not be in a position to ensure the quality nor the substance of the documents. The cumulative paperwork and compliance burden upon franchisors is likely to be significant and would be at odds with the Government's policy of reducing the regulatory burden on business, where possible.’⁶⁸⁴

The Government noted, apparently by way of vitiating the need for registration of disclosure, that the Franchise Council of Australia had announced a national franchise-accreditation scheme. As of this writing there is no information publicly available to non-members of the FCA regarding the scheme, and no indication of when and how it might be implemented.⁶⁸⁵ Registration would probably not be more burdensome on franchisors, as they already prepare the disclosure documents; it would mean an increased responsibility for the regulator, but the benefits are significant.

⁶⁸³ See Recommendation 23, the Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993>> at 14 May 2007.

⁶⁸⁴ Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct, February 2007, <[http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.industry.gov.au/assets/documents/itrinternet/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf)> at 14 May 2007.

⁶⁸⁵ The only information available from a general search of the Internet was a US Commercial Service first issue of the bi-annual Franchising Update, inaugural issue, January 2006.

6.6.3 Measures to ensure participants' ability to act on the information

The third issue, the fact that franchisees cannot act on the information, is perhaps the most difficult to address, but there are ways to improve a franchisee's ability to act on the disclosed information and so to help achieve the purpose of disclosure generally, which is to allow the recipient to act on the information through negotiation and/or choice of alternatives in the market.

The concept of a 'market for terms' has been posited as a means to balance bargaining positions where standard form contracts are used. If a franchisee does not agree to the terms, it can in theory 'enter the market through alternative means.'⁶⁸⁶ According to this theory the contract is part of the package a franchisor is selling; and in a competitive market, consumers can shop around for the supplier that offers the most favourable terms. A franchisor might, for example, market the franchise system by ensuring prospective franchisees that, unlike our competitors, 'our contract gives you peace of mind with respect to termination, encroachment, etc. ...' and/or 'our contract ensures fair, efficient conflict management and dispute resolution processes'. The market for terms/contract-as-sales tool offers a variety of potential benefits, such as engendering contracting parties' awareness of their rights and obligations under the contract, and reducing the incidence of unfair surprise. It can supplement consumer education about the nature of the contract, as it would increase both franchisors' and franchisees' attentiveness to contract terms from the outset. Further, by bringing business people back into their own contracts, the roles of both solicitors and regulators may be trimmed, thus making the contract more relevant to the parties themselves.⁶⁸⁷

In practice, though there are alternatives in the market for franchises generally, it may be that the alternatives are limited for a franchisee to find favourable contractual terms. The results of this research suggest that the terms in franchise contracts tend

⁶⁸⁶ James V. Jordan and Judith B. Gitterman, 'Franchise Agreements: Contract of Adhesion?' (1996) 16 *Franchise Law Journal* 1, 15. See also: *Burger King Corp v Rudzewicz* 471 US 462 (1985) and David Hess, 'The Iowa Franchise Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors' (1995) 80 *Iowa Law Review* 333, 340-41.

⁶⁸⁷ "Llewellyn... missed the significance ...that it is very often the lawyers expertise, not the businessman's that is revealed": Todd D. Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' in John J. A. Burke (ed), 'Reinventing Contract' (2003) 10(2) *Murdoch University Electronic Journal of Law* [180] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003.

toward uniformity not only within each franchise system, but even across different franchise systems and different industries. With respect to contract terms there may be no discernable difference to a franchisee which franchise it chooses. If competitors do use similar terms, effectively there are fewer alternatives in the market. As franchise lawyer and commentator Rupert Barkoff notes, ‘...While prospective franchisees always can decide not to buy franchises, many of the provisions that franchise advocates find objectionable have become ‘industry standard.’⁶⁸⁸

This uniformity in contracts reinforces itself. If the terms are uniform, franchisees may not bother to read them. And if franchisees do not read or understand the terms, there is little incentive for franchisors to improve them. This situation is even more pronounced if the contractual term is not of high priority or is poorly understood by a franchisee. Even where there are differences, the prospective franchisee cannot shop for terms because the contract is not provided to a franchisee until very late in the bargaining process. Prospective franchisees are not in a position to compare contracts. The market for terms may not be effective without other complementary measures, for example a contracting community, wide use and understanding of terms, all of which mean education and public relations efforts and also may be best achieved collaboratively.

Perhaps one contribution of research such as this is to highlight the differences in contract terms where there are differences, to help parties make more informed use of the contract and to raise awareness of the alternatives.

With respect to the problems engendered by the relational aspects of the contract, because a relational contract emphasizes the ‘trust us’ aspect of the relationship, and so detracts from the psychological importance of franchisee due diligence, it may be necessary to counter-balance this with educational programs that emphasize the importance of franchisee due diligence. Several franchisees interviewed in the course of this research indicated that they simply had failed to ask the questions that should have been asked. Though disclosure cannot be used to illuminate such details of the relationship that are left to a franchisor’s discretion, it is perhaps worthwhile to explain generally the nature of this dynamic to a franchisee and/or to bring to a franchisee’s attention to which aspects of the contract are left to franchisor discretion.

⁶⁸⁸ Rupert M. Barkoff, ‘Drafting Tips: Pitfalls of Preparing a Franchise Agreement’ (2002) 8 *Franchising Business and Law Alert* 5.

Finally, it may be necessary to balance disclosure that addresses contract formation with other regulation that addresses performance of the contract over the period of years. The philosophy behind a regulatory focus on contract formation is that the state can protect parties in entering contracts, to ensure the agreement they reach is fair, but that the courts should not re-write agreements once they are made. This philosophy, however, has been eroded in other areas of contract law, such as employment law and consumer protection. A similar shift away from this philosophy in the franchise context may be appropriate because the employment and consumer-like attributes of the relationship mitigate in favor of regulation that reflects these conditions, and not just protection of a franchisee in an investor role. Also, the terms of the contract deal primarily with performance obligations, not formation and termination of the contract,

‘The most chilling fact to come out in the hearing was that while the FTC [Federal Trade Commission] continues to concentrate its enforcement efforts on pre-sale franchise issues most of the problems faced by franchisees are post-sale, after the contract is signed, i.e., encroachment, sourcing of supplies, etc.’⁶⁸⁹

Australia’s current regulatory program provides little protection for a franchisee to ensure the performance of a franchisor.

6.7 CONCLUSION

Using disclosure to alleviate franchisee misperceptions that might otherwise lead to conflict seems a perfect solution to franchise relationship imbalance and uncertainty. The reality, however, is that even with disclosure problems persist. This is because information provided may be inadequate, and also because, even where the information may be adequate, a franchisee may not be able to use it.

This chapter outlines the conditions that are considered essential for effective regulation by disclosure, to gauge the risks; to ensure that reliable information is obtained and disseminated in an accessible and useable form; and to ensure that recipients can act upon the information. This chapter then explains why disclosure does not meet these conditions.

⁶⁸⁹ Hearing held June 25, 2002 before the U.S. House of Representatives Subcommittee on Commerce, Trade and Consumer Protection, <http://www.franchisee.org/Blast%20Fax/0207%20Blast%20Fax%20Special%20Edition.pdf> at 10 September 2007.

With respect to the first condition, there is a lack of reliable information needed to gauge the risks in informing the design of regulatory process and the selection of regulatory tools. This information is needed also to determine how regulatory tools are applied. In the application of disclosure, for example, the risks have not been gauged by participants in a participative regulatory process to determine what information must be provided, either about the nature of the enterprise generally or about a specific franchise system.

With respect to the second condition there are difficulties with ensuring that the information a franchisee receives in the disclosure document is reliable, accessible and useable. The accessibility and useability of the information that is disclosed is compromised in a variety of ways. The right information is not always provided; both about the general nature of the franchise relationship and about the particular franchise system. There is no registration of disclosure, no monitoring to ensure compliance, and there are inconsistencies with other regulation. The language of disclosure can be unclear, and the presentation and timing of the information is not always consistent with the need for the information. Finally, franchisees are not 'rational actors' in their use of the information.

Finally, the third condition is to ensure that a franchisee is capable of acting upon the disclosed information. Effective disclosure works by improving flows of information in order to improve the ability of a franchisee to negotiate and to improve the ability of a franchisee to select alternatives in a market. A franchisee's ability to act on the information is impaired by the nature of the contracting relationship.

Because it is a standard form contract and because many terms are common across the sector, the two fundamental purposes of disclosure are impaired. First, in theory, disclosure helps to improve market function by redressing information asymmetry and so improving the ability of parties to negotiate the contract. In the case of franchising, however, disclosure is ineffective because, where there is no negotiation of the contract, disclosure cannot improve a recipient's negotiating position. Secondly, disclosure helps to improve market function by providing information about alternatives in the market. In this function as well disclosure cannot be optimally effective in the case of franchising. It fails to help a franchisee with its choice of alternatives in the market because there are limited alternatives for contract terms and

because the timing of disclosure is usually later in the process than would be necessary to facilitate comparison shopping by franchisees.

Not only does the standard form quality of the franchise contract impede effective disclosure; the relational nature of the contract is also inconsistent with disclosure as a regulatory tool. In relational contracting significant parts of the contract are left unspecified, and therefore cannot be disclosed.

Disclosure can be enhanced by encouraging more independent research, improving the quality, the timing and presentation of information made available to franchisees as well as education about and monitoring and enforcement of disclosure provisions. There is a need for better information about the nature of franchising generally. There is also a need for more specific information about the particular franchise system. To ensure greater clarity in disclosure with respect to terms of the agreement, more detailed information should be provided about, for example, payments, earnings, intellectual property, and tenancy. The Code also needs to be consistent with other regulation, such as TPA section 52. Finally, disclosure should be provided in a manner that is timely and accessible. Some of these measures to improve the function of disclosure can be conducted through collaborative initiatives that include better franchisee education programs and wide use and understanding of contract terms, as well as information about the general nature of the franchise relationship and the franchise agreement. Collective initiatives could also provide a source of information to prospective franchisees about franchisor reputations.

There is no one means by which to refine and improve the operation of disclosure, just as disclosure is not the only method by which the sector is or might be regulated. Currently, disclosure is widely used in the regulation of franchising, not only in Australia, but in many jurisdictions that regulate franchising. Its appeal as an appropriate regulatory tool for the sector is in part attributable to its self-regulatory qualities. It is efficient and low-intervention, as it allows the people who are in many ways best suited to the task, the parties themselves, to be participants in their own regulation.

Because disclosure does not meet the conditions for effective informational regulation, however, it cannot be relied upon as the principal tool for regulating the franchise relationship. There is no evidence that disclosure makes a significant

difference in consumer or market behaviour. A franchisor can be in compliance with the Code of Conduct and have provided little information that makes any guarantee or is useful to franchisees. Disclosure puts the burden and much of the cost of regulation on the parties themselves; it does not protect franchisees substantively.

Regulators have viewed franchising as a business-to-business transaction, not in need of higher levels of regulatory protection afforded to consumers when they transact with business. This evaluation of the power in the relationship is inaccurate; and it is one reason why disclosure as it is currently designed is ineffective as the principal tool used to regulate franchising. Disclosure can be effective only if a franchisee is properly positioned to fulfill its role. The current status of a prospective franchisee in Australia is that it is not a full participant in the process and it is not adequately equipped to play the important role it has been assigned in the regulatory process. There is an imbalance of power in every aspect of the franchising relationship, including the regulatory process itself.

Franchising presents a situation where, ‘Private law failure feeds the need for regulation.’⁶⁹⁰ There is a need for a comprehensive regulatory scheme that does not rely upon, but supports and enhances the self-regulatory sphere through effective direct intervention. If the regulation of franchising is to continue to emphasise disclosure, any future program should include careful consideration of how a franchisee can play its role in the disclosure process. A franchisee needs the right information, information that is reliable, accessible and useable. Most importantly, a franchisee must be able to act upon the information.

Enhanced substantive protections for a franchisee should also be considered. Regulatory intervention and reform should not single out particular tools; it should instead start with process, with selection of tools as one step in that process. This chapter has focussed on disclosure specifically. The next chapter considers ways to reform a comprehensive regulatory process in order to improve regulatory results.

6.8 CHAPTER SUMMARY AND RECOMMENDATIONS

This chapter has explained why disclosure fails to address the imbalance of power and the uncertainty for a franchisee in the franchise relationship. The main points and recommendations are as follows:

⁶⁹⁰ Julia Black, *Rules and Regulators* (1997) 54.

- The Code relies on disclosure as a regulatory tool.
- The conditions that are considered essential for effective regulation by disclosure, gauging the extent and magnitude of the particular risks; obtaining reliable information; disseminating information in a form that is both useable by and accessible to the community; and ensuring options for the target audience to act upon the information, are not met.
- The reasons why disclosure does not meet these conditions are as follows:
 - there is not enough reliable information to gauge the risks in informing the design of regulatory process and the use of regulatory tools;
 - the information a franchisee receives in the disclosure document is not reliable, accessible and useable because the right information is not always provided; there is no registration and no monitoring to ensure compliance; the language of disclosure can be unclear; the presentation and timing of the information is not always consistent with the need for the information; and franchisees are often inexperienced and ill-equipped to use the information;
 - the standard form and relational qualities of the contract impair a franchisee's ability to act on the information:
 - because the contract is not subject to negotiation; and
 - because there are limited alternatives for contract terms and because of the late timing of disclosure.
 - the relational nature of the contract is also inconsistent with disclosure as a regulatory tool. In relational contracting significant parts of the contract are left unspecified, and therefore cannot be disclosed.
- The Franchising Code of Conduct is a low-intervention form of regulation as it relies principally on less interventionist methods such as disclosure.⁶⁹¹
- Disclosure does not meet the conditions necessary for it to function effectively.

⁶⁹¹ Anthony I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) 5.

- Disclosure puts a heavy burden on a prospective franchisee to be equipped to receive, understand and act upon the disclosed information. This form of regulation can be effective only if a franchisee is properly positioned to fulfil this role.
- Current participation by franchisees in regulatory processes is very limited and based upon arbitrary processes of selection. A prospective franchisee must be a full participant, equipped to play the important role it has been assigned in the regulatory process.
- Disclosure is ineffective in addressing the imbalance of power and the uncertainty for a franchisee in the franchise relationship. The process of regulation needs revision to improve the use of tools and incorporate the full and effective participation of franchisees.

Chapter Seven

Conclusion and Recommendations:

Reframing Regulation to Improve its Effectiveness⁶⁹²

‘Man’s capacity for justice makes democracy possible, but man’s inclination to injustice makes democracy necessary.’⁶⁹³

7.0 INTRODUCTION

This chapter summarizes the main points of the dissertation. The market interaction and the franchise contract establish and reinforce the imbalance of power and uncertainty in the relationship. Contract terms indicate the ineffectiveness of regulation in addressing imbalance of power and uncertainty because they continue to manifest, and indeed reinforce these conditions. Direct intervention is not effective in redressing the imbalance of power in the relationship or in alleviating the uncertainty of franchisees. The second part of Chapter Seven offers some recommendations. In order to improve the performance of both private and public levels of regulatory governance, Chapter Seven proposes reframing regulation, first by instituting collaboration that includes franchisees in all stages of regulation. Secondly, it recommends a process-oriented approach in order to ensure better measurements and better information about the sector. Finally, this chapter offers some ideas as to how this information can in turn be used by stakeholders and the regulator to identify problems and to select the appropriate regulatory tools to address them.

7.1 CONCLUSIONS FROM THIS RESEARCH

After thirty years of regulation of the franchise sector in Australia, there is still no consensus about the effectiveness of the regulatory program for franchising. Silvana

⁶⁹² The technique of reframing in neuro-linguistic programming (NLP) involves confirming positive intentions behind the behaviors that one seeks to change. Alternatives to satisfy the positive intent are found, followed by negotiations with self to resolve conflict, check for ecology and to implement the new behaviours. Reframing is also used in NLP to describe changing the context or representation of a problem. More precisely, one of the most effective techniques for achieving almost any desired change in NLP is the "six step re-frame". See <http://www.semanticstructuring.com/anthro_ideo.php at 23 July 2007.

⁶⁹³ Reinhold Niebuhr, *Remembering Reinhold Niebuhr: Letters of Reinhold and Ursula M. Niebuhr* (1991).

Sciarra wrote in 1991 that, '[T]he degree to which franchisees are under-protected remains just as highly debatable as their state of subordination.'⁶⁹⁴ The degree to which franchisees are protected remains just as debatable today.

In order to answer that question, this dissertation proceeded from the premise that, in order to be considered to be effective, regulation must achieve its goals. The objectives of government action in implementing the regulation of the franchise sector included raising standards of conduct in the franchising sector without endangering the vitality and growth of franchising; reducing the cost of resolving disputes in the sector; reducing risk and generating growth in the sector by increasing the level of certainty for all participants; and addressing the imbalance of power between franchisors and franchisees. The dissertation did not address the objective of reducing costs of dispute resolution or the overarching objective of raising standards of conduct while protecting the vitality and growth of the sector, but it did assess how well regulation has met the latter two stated objectives of regulation, redressing the imbalance of power between franchisors and franchisees and increasing the level of certainty for all participants.

The framework for this analysis of whether the regulation of franchising is effective is based upon current theories of regulatory activity frame, theories that frame regulation as a broader function than the traditional view of regulation as a set of rules imposed by government. Regulation encompasses many different tools, many potential participants, and many strategies in a multi-layered system of governance. This multi-layered system of governance provides the framework for the analysis of the regulation of the franchise relationship; it encompasses self-regulation through private interaction between the parties in market and contract as well as public intervention through legislation.

Chapters Three through Six together demonstrated that regulation does not adequately achieve the two goals of redressing imbalance of power and uncertainty for all participants. Chapter Three provided an introduction to the nature of the franchise sector, explaining that the parties' self-regulation of the relationship through the market interaction establishes conditions of imbalance of power and uncertainty for a

⁶⁹⁴ Sciarra Silvana, 'Franchising and Contract of Employment: Notes on a Still Impossible Assimilation' in Christian Joerges (ed), *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (1991) 254.

franchisee. A franchisee is not well-equipped to understand the nature of the franchise relationship. The lack of reliable information about the sector generally and about individual franchisors means that a franchisee may not understand the product, and may enter into a franchise business with significant misconceptions. A franchisor is typically more experienced in franchising, and generally has a better understanding of the nature of franchising and its own motivations for participating in this business form. In the market interaction a franchisor is selling a product about which a franchisee has, in form and substance, only the information a franchisor makes available to it. A franchisee functions less as an active participant in a business relationship, and takes on qualities of investor, consumer, and employee, among others.

The market interaction between franchisor and franchisee is characterized by asymmetry of information, imbalance of power, and concomitantly high uncertainty for a franchisee. In another layer of governance, the self-regulation of the franchise relationship by means of the contract, a franchisee is also less than an equal and active participant. Chapter Four explained how the standard form and relational qualities of the contract increase uncertainty and imbalance of power. The standard form contract, drafted by a franchisor without consultation or negotiation with a franchisee, by definition involves imbalance of power in the contracting relationship. It also means higher levels of uncertainty and risk for a franchisee. The relational quality of the contract contributes to the imbalance of power and to uncertainty for a franchisee because conditions of the agreement cannot be specified and because a franchisor is accorded virtually all contractual discretion to accommodate future uncertainty. Together, the standard form and relational qualities of the franchise contract add to the imbalance of power and to uncertainty for a franchisee because a franchisor has power, while a franchisee must rely on trust and reputation; because a franchisor can manage risk through contract, while a franchisee cannot, and because the relationship can only take shape over time according to the will of the drafting party that has accorded all discretion in the contract to itself. In the contracting process as in the market interaction a franchisee takes on qualities of consumer of product, its role is not that of an equal party to the negotiation of terms. Self-regulation through the contract thus reinforces the imbalance of power and uncertainty of the arrangement for a franchisee.

In addition to its evaluation of contract in theory as a means of self-regulation by the parties, this dissertation evaluates contract terms as an indicator of regulatory effectiveness overall. Contract terms were sampled and these terms were compared and assessed with respect to the extent to which they indicate that the goals of regulation are being met. The results of the content analysis of a sample of franchise contracts, and showed how the contract in practice does reflect an imbalance of power and high levels of uncertainty for a franchisee. For example, the Independence of Franchisee clause allows a franchisor to attempt to avoid duties and responsibilities to its franchisees by disclaiming any relationship of partner, agent, joint venturer, or employee, but at the same time retaining tight control over the activities of franchisees. The Scope of Grant clause delineates and effectively limits the rights of a franchisee, while specifically reserving rights, such as use of the intellectual property, and discretion to a franchisor. The franchisee's 'right of renewal' is not actually a right but rather a set of conditions restricting a franchisee's ability to renew. With respect to advertising each franchisee pays into the marketing fund but, a franchisor often has absolute discretion over how to spend the fund. With respect to supply a franchisor controls supply requirements, while a franchisee agrees to comply to conditions it can neither control nor predict. A franchisee must meet performance targets that are set and can be changed by franchisor at its discretion. Many systems require that franchisee books, records, and computer systems are available to franchisor, though the reverse is not true. In the event of transfer all rights and obligations of franchisee are personal to a franchisee, while a franchisor is unfettered in its ability to transfer rights and obligations under the contract. A franchisee has specific obligations; if breached franchisor may terminate. Franchisor has vague obligations; there is little recourse for franchisee if franchisor does not perform. Franchisors in some systems can make changes to the agreement unilaterally. A franchisor can also change operations manual, computer systems, and may enjoy control over franchisee premises. Franchisees must comply even if they do not agree.

Chapter Five also briefly described the applicable case law and statutory regulation, usually consisting of requirements to disclose. The contract terms indicated that conditions of uncertainty and imbalance of power among the parties persist, despite attempts to regulate. Chapter Six examined the reasons why disclosure fails to address the imbalance of power and the uncertainty for a franchisee. Having outlined

the conditions of effective regulation by disclosure, it explained that disclosure does not meet these conditions. First, disclosure has a strong self-regulatory character; the parties themselves must be equipped to make it work. The Franchising Code of Conduct relies on a franchisee to carry out regulatory function through its role in disclosure, which requires a prospective franchisee to be able to receive, understand and act upon the disclosed information. For several reasons, however, a franchisee is constrained from playing its role. Disclosure is only effective where a recipient receives accurate, reliable information and is equipped to act on that information. These and other conditions, such as proper monitoring, are not assured in the operation of disclosure in franchising.

Chapter Six also revisited the standard form and relational qualities of the contract. Not only do these qualities exacerbate the imbalance of power and uncertainty in the contracting process as outlined in Chapter Four, but they also impair the fundamental purpose of disclosure, which is to allow the recipient to act on the information, usually to negotiate or to find alternatives. The relational nature of the contract is also inconsistent with disclosure as a regulatory tool because significant parts of the contract are left unspecified, and therefore cannot be disclosed. Disclosure as a regulatory strategy is therefore inconsistent with standard form and relational characteristics of the contract and for this reason disclosure may be less effective than it might be where other types of contract are used. Because disclosure in franchising does not meet the conditions required for its effective operation, it is not effective in addressing the imbalance of power and the uncertainty for a franchisee in the franchise relationship.

The governance of the franchise relationship involves self-regulation at the market and contract layers; direct intervention is also self-regulatory in character. This dissertation has demonstrated that all these layers of governance set up and reinforce conditions of imbalance of power and uncertainty for a franchisee. The solution to the problems in the franchising relationship cannot lie in self-regulatory measures, such as market function or contract, or tools of direct intervention that are self-regulatory in nature such as disclosure. Regulation cannot rely upon and reinforce self-regulatory instruments as a means to achieve ends that run counter to the conditions in those instruments, in this case imbalance of power and uncertainty.

Imbalance of power and uncertainty are inherent in the relationship. They are reinforced by private governance of the relationship. In the franchising sector, given the characteristics of the contract and the context of the relationship, self-regulation cannot be effective unless all participants are assured a place in the regulatory process, at every level of governance. It is illogical to resort to self-regulatory options unless the basic calculus of those self-regulatory options were to be made functional by a real effort to include franchisees.

The failure to recognise and address the problems in the regulation of franchising is due to deficiencies in regulatory process. In the existing regulatory process problems have been identified according to political pressures, anecdotal evidence, and surveys that emphasize the opinions of one half of the sector. Objectives are generally and broadly stated. Tools have been adopted largely from other jurisdictions, and they are often incompatible with the fundamental nature of the franchise contract and the sorts of problems it presents. The history of the regulation of franchising is therefore inconsistent with best practice in regulation.

7.2 RECOMMENDATIONS

Because regulation as it is currently conceived is ineffective, this dissertation recommends a reframing of regulation of the franchise sector. It explains the reasons why regulation requires a change in context starting with investment in collaborative process. It also explores some steps that can be taken toward implementing this change.

Such a reframing would have several benefits. By enlisting the participation of all stakeholders, franchisees as the protected interest would be better represented to the regulator and in every aspect of the governance of the relationship. The regulatory process would correct rather than contribute to the imbalance of power and uncertainty within the very process of regulation at all levels. Full involvement of stakeholders would lead to better information, more accurate identification of problems and more effective use of wider range of tools. With better information, reframed regulatory practice would fit more closely the needs of the sector and have greater legitimacy, accountability and responsiveness. Overall, regulatory practice would better conform to the 'new learning' of regulation.

7.2.1 The importance of franchisee participation in collaborative process

The element that is most central to a reframing of process is described by Julia Black and others as democratic, participative and responsive regulation and characterized by Sparrow as collaborative process. As Chapter Two outlined, without clear proof and clear consensus, regulation lacks legitimacy and accountability. Best practice in regulation requires that regulatory processes be participative, responsive, and transparent; investment in collaborative partnerships is an integral part of the progress toward these ends.⁶⁹⁵

In order to achieve this style of regulatory process in franchising there is a need to reframe the roles of and relationships among the regulator, stakeholders and trade association(s). As Warren Pengilley observes,

‘The fact of regulation has nothing to do with who does the regulation. A regulator is any person with the power to regulate. Private parties may be regulators just as effectively as many government entities.’⁶⁹⁶

The most fundamental and pervasive problem in the regulation of the franchising relationship at all levels is the lack of a fully-participative process. The intention of a franchisee is not clear in the market interaction; a franchisee enters the relationship with misconceptions about the nature of the relationship. A franchisee is then foreclosed from participating in the contracting process in which it acts as a consumer and as the weaker party to a standard form contract. With respect to statutory regulation, even though it is the protected interest, a franchisee has a negligible voice at the table with government officials in formulating regulatory intervention.

⁶⁹⁵ While other methods have been proposed as a means to achieve legitimacy in regulation, they may not be suitable for the franchising context. For example, Stephen Breyer has proposed the use of expertise as opposed to democratic policy-making, and due process participation. The problem here is generating the required level of interest and funding and harnessing the required expertise. Because of the serious deficiency of reliable information about franchising, such expertise may be impossible to engage. Also suggested is scientific proceduralism, a concept that in theory could work in the regulation of franchising, but that also has several practical disadvantages. Baldwin et al, *Understanding Regulation: Theory, Strategy and Practice* (1999) 146-148; See Malcolm Sparrow ‘Innovating in a Regulatory Environment’ (Speech delivered at the National Environmental Innovations Symposium, Kansas City, 6 December 2000 <<http://www.epa.gov/innovation/symposium/docs/sparrow.pdf>> at 17 September 2007; Peter Vincent-Jones, ‘Contractual Governance: Institutional and Organisational Analysis’ (2000) 20 *Oxford Journal of Legal Studies* 317; Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1, and David Hess, ‘Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness’ (1999) 25(1) *The Journal of Corporation Law* 41.

⁶⁹⁶ Warren Pengilley, ‘Competition Regulation in Australia: A Discussion of a Spider Web and its Weaving’ (2001) 8 *Competition & Consumer Law Journal* 2, 51.

To the extent that collaborative process exists in the regulation of the franchise sector, it excludes a key stakeholder, the protected interest, that of franchisees. A franchisee is marginalized in every aspect of the regulatory process, while a franchisor plays a central role in every aspect of the regulatory process and so dominates the governance of the relationship. Imbalance of power and uncertainty for a franchisee will persist as long as a franchisee is left out of every stage of the regulatory process.

Adequate regulation depends on adequate representation of both franchisor and franchisee interests in rule-making fora. The under-representation of franchisee interests in all the 'layers' of regulation is a major problem. The focus of regulators and the evaluation of regulation has been on the supply side. To improve the ability of franchisees to act on the disclosed information, the regulatory focus needs to shift from the supply side and consider more fully both the supply and the demand side.⁶⁹⁷

In reference to the 'new learning' on regulation, Ramsay notes that,

'The distributional effects of this new architecture of regulation remain contested. Braithwaite and Drahos ... argue that although there are opportunities for 'liberalising populism' within the new global order, business influence through states or international standardisation bodies is often disproportionate to that of consumers in the development of regulation.'⁶⁹⁸

A franchisor's activities are important, but regulators must take a balanced view of both sides of the contracting relationship, considering the efficacy of regulation from the point of view of the protected interest, a franchisee. This is not what has been happening in the regulatory process to date.

7.2.1.1 Obstacles to franchisee participation

Collaborative process requires reframing the roles of all participants in all layers of the regulatory process; in particular the role of franchisees must be revised and more favourable conditions ensured for franchisees seeking to participate. Franchisees cannot be expected to fulfil their role in regulatory process if they lack the ability and the tools to participate. As Ramsay notes, regulatory programs, 'often make heroic

⁶⁹⁷ Roundtable on Economics for Consumer Policy Summary Report, Organisation for Economic Co-operation and Development, Directorate for Science, Technology and Industry Committee on Consumer Policy <<http://www.oecd.org/dataoecd/5/38/39015963.pdf>> at 28 July 2007.

⁶⁹⁸ Iain Ramsay, 'Regulatory Capitalism and the 'New Learning' in Regulation', 28 *Sydney Law Review* 9 (2006).

assumptions about the ability of consumers to use and process information on market choices and their ultimate results remain uncertain and difficult to measure.⁶⁹⁹

There are significant constraints that impair the capacity of franchisees to act collectively. This dissertation has discussed the limitations on the franchisee's role in the regulation of the franchise relationship through private layers such as the market interaction and contract as well as through the public layer of statutory regulation. These limitations include the general conditions of imbalance of power and uncertainty for franchisees in the market interaction, in contract and in the process of direct intervention.

Some of the same characteristics of franchisees that lead to their subordinate positions to franchisors also contribute to their under-representation in all layers of governance. Their independence and individualism isolates franchisees, and this isolation is exacerbated by the fact that dissatisfied franchisees that collaborate to effect change may face threats of defamation and potential violation of antitrust statutes.⁷⁰⁰ Franchisee collective action is also thwarted in dispute resolution processes under the Code. Procedures for collective action by franchisees have, until recently, not been provided under Code-mandated mediation. With respect to litigation, in addition to the deterrent effect of the 'loser pays' system, class actions have until recently been discouraged by Australian rules of procedure.⁷⁰¹ Franchisees' collective action may also be discouraged by the fact that courts may find a lack of good faith on the part of franchisees who communicate dissatisfaction with the system to other franchisees.⁷⁰²

Franchisees need to find ways to overcome these conditions. They cannot be passive if they want to move beyond 'infantilization',

'A decentred regulatory approach might include initiatives that aim to 'responsibilise' both the supply and demand side of consumer markets...the new learning on regulation positions the consumer as an important regulatory subject

⁶⁹⁹ Ibid.

⁷⁰⁰ Australian defamation laws generally have been less protective of free-speech oriented than are such laws in the US.

⁷⁰¹ This is to be remedied to some extent by recently introduced legislation, but the impact if that will not yet be apparent.

⁷⁰² The Privy Council determined in the Dymock's case that a franchisee's conduct of stating, in a facsimile sent to other franchisees, that it would not participate in franchisor activities was a repudiation of the franchise agreement. See *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*, [2002] UKPC 50, [2004] 1 NZLR 289.

perceived as crucial to achieving national goals such as greater competitiveness.’

Franchisees cannot expect to be protected by the regulator, but must accept responsibility for their role in the regulation of the franchise relationship.

7.2.1.2 The role of trade associations in enhancing franchisee participation

Another factor in the lack of franchisee representation in the current regulatory process is their lack of representation in the principal trade association, the Franchise Council of Australia (the FCA). Private and public interest groups have for many years had a significant role in regulatory process.⁷⁰³ The trend has been to rely heavily on sectoral involvement in industry ‘self-regulation’.⁷⁰⁴ This approach has appealed to regulators in cutting costs and shifting the onus of regulation to the participants. Concomitant with the increased emphasis on industry self-regulation, in Australia the regulator has relied on the trade association as a principal participant in regulatory process. This is a phenomenon that has since become somewhat discredited,⁷⁰⁵ but today the regulatory process still involves primarily the regulator and the trade association, the Franchise Council of Australia. The Franchising Code of Conduct retains largely the same form as the original voluntary Code of the mid-1990s.

The arrangement of franchise industry groups often fails to reflect alignment of franchisor and franchisee interests. In most countries the predominant trade association involved in promoting the sector, lobbying politicians, and educating constituents and others about the activities of the sector is the franchisor industry association. Industry groups and associations in franchising have the power to engender greater participation of franchisees and to lobby on behalf of franchisees’ interests, but there is little evidence that they have done so, ‘It may be that “there’s a sucker born every minute” but this does not excuse the conduct of abusive franchisors, nor the failure of franchisor trade associations to take a position in favour of fair dealing.’⁷⁰⁶ In order to improve relationships within the sector and to

⁷⁰³ Ian Ayres, John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992).

⁷⁰⁴ Iain Ramsay, ‘Consumer Law, Regulatory Capitalism and the ‘New Learning’ in Regulation’, 28 *Sydney Law Review* 9 (2006).

⁷⁰⁵ Ibid.

⁷⁰⁶ Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn State Law Review* 105, 316.

minimize opportunistic behaviour, franchisors' and franchisees' interests should be aligned as much as possible.⁷⁰⁷ The 1997 Reid Report recommended that the Code should 'provide for adequate representation of franchisees in merchants' associations.'⁷⁰⁸

The Franchise Council of Australia (the FCA) is the only active industry association in the country.⁷⁰⁹ Though franchisees are encouraged to join,⁷¹⁰ the majority of its members are franchisors.⁷¹¹ As its membership consists primarily of franchisors, the FCA promotes franchisor interests, often at the expense of the interests of franchisees. So, while the FCA is a franchising organization, symbolically it represents only one half of the franchise relationship. Numerically, franchisors represent fewer than half of the participants in the franchise sector. Even at reduced rates, membership is costly for many franchisees to maintain especially where they see few benefits of membership in an organization that serves primarily the interests of franchisors.

The French Franchise Federation (the FFF) and the American 'International Franchise Association' (the IFA)⁷¹² are two national franchise organizations that are actively

⁷⁰⁷ Rod Wakefield, CEO of The Coffee Club, address to the FCA 23 October 2006.

⁷⁰⁸ Recommendation 3.1 (paragraph 3.30), *Finding a Balance: Towards Fair Trading in Australia* (1997) House of Representatives Standing Committee on Industry, Science and Technology - Parliament of Australia <<http://www.aph.gov.au/house/committee/isr/Fairtrad/report/append.pdf>> at 4 December 2006.

⁷⁰⁹ According to its website, the FCA was formed in 1983 as a not-for-profit trade association, with the following objectives: To establish standards of international best practice in business format franchising for Australian franchise systems; To provide information and education about franchising to existing and potential franchisees and franchisors; To lobby state and federal governments on issues relevant to the sector. Since 1983, these objectives have been further expanded to include the following: To develop a vital, strong and financially viable franchising sector; to advance the interests of members in Australia and in special interest markets such as the international franchise community, Franchise Advisory Councils, Small Business Forums and property leasing organisations (particularly shopping centres). To continually foster among consumers, governments and the business community, a broad-based understanding of the economic importance of having a strong franchising sector in Australia. To design efficient, identified, value-added services to members and assist them to be more effective in franchising. See Franchise Council of Australia (2006) <<http://www.franchise.org.au/> at 10 June 2006.

⁷¹⁰ Lower priced categories of membership are available for franchisees, some without voting rights. See <<http://www.franchise.org.au/content/?id=2> accessed 10 June 2006.

⁷¹¹ <<http://www.franchise.org.au/index.cfm?fuseaction=list>> at 4 May 2007.

⁷¹² The International Franchising Association (the IFA) is the primary industry group in the US. The IFA's new self-regulation program offers an 'effective alternative to litigation and legislation, both of which are costly, time-consuming and potentially destructive to franchising'. An important aspect is that it integrates franchisors and franchisees within the organization, enabling cooperation among interested parties to find effective solutions apart from litigation and government regulation. Other related initiatives include streamlined enforcement; an ombudsman who, in the case of a dispute serves as the 1st point of contact; a reward/recognition program; and new educational programs (especially on-

working to align the interests of franchisors and franchisees by unifying them as members in one association. The IFA, for example, offers a deeply discounted rate to franchisees who wish to attend the national convention; no such discounts are offered by the FCA.

Another option is to ensure that franchisees can function collectively through franchisee associations that operate independently of the FCA. There are various forms of franchisee organization. The two most common are franchising advisory councils (commonly referred to in the industry as FAC's) and independent franchisee associations. The difference is that a franchising advisory council denotes a franchisee organisation that is set up and to a greater or lesser extent controlled by a franchisor.⁷¹³ It may also be funded in part by a franchisor. Because of this, an FAC may have less credibility among franchisees than an independent franchisee association.⁷¹⁴ Franchisors prefer FAC's because they enjoy participation and a level of control over such organizations that they do not have with independent franchisee associations. Some consultants advise franchisors to set up a FAC's in order to prevent franchisees instituting independent associations that are removed from franchisor control and are likely to have a more franchisee-proactive posture.

Independent franchisee associations for particular systems are common in the US. Such groups, however, appear to be rare in Australia. The Chairman of the FCA has suggested that the climate in franchising is more collegial in Australia than in the US and for this reason Australian franchisees are more likely to be adequately served by franchisor-organized FAC's rather than independent franchisee associations.

In addition to, or as an umbrella for franchisee associations for particular systems, franchisees that are under-represented by the FCA could form a national franchisee organization. Franchisee associations, where they exist, tend to operate independently of franchisor associations with lower budgets, lower visibility and less political

line education) to serve the needs of both franchisors and prospect franchisees. See the International Franchise Association, *IFA Self Regulation Program* (2005) International Franchise Association <<http://www.franchise.org/content.asp?contentid=770>> at 31 December 2005.

⁷¹³ For Rupert Barkoff's views on this distinction see <<http://www.kilpatrickstockton.com/publications/downloads/FIVol3No2.pdf>> at 15 February 2006.

⁷¹⁴ Sixty-five percent of Australian franchise systems surveyed report having an FAC or something similar. C. McCosker, L. Frazer and D. Pensiero, An exploration of Franchise Advisory Councils: Expectations and relationships, in Welsh, DHB (ed), *The International Challenge .. Towards New Franchising Relationships*, Proceedings of the Society of Franchising Conference, (1995) 1-26.

representation. Attempts at starting such organizations in Australia have met with little success. As noted above, franchisors suggest that franchisees are already adequately represented, while the government's attitude seems to reflect the franchisor's mistrust of franchisee organizations. Rather than encouraging franchisee participation,

'the Australian Government has signalled that it would not directly oppose the formation of a representative body for franchisees. In late June 2006, Australian Small Business Minister, Fran Bailey, stated that collective bargaining can help franchisees reach better deals with big business. However, Bailey refused to comment specifically on franchisee representative associations. Meanwhile, the Australian Competition and Consumer Commission has stated that, while it does not want an "ACTU-style" franchisee body, it would adopt a "pragmatic and informative approach" to franchisee interests if a voluntary association were to be created in Australia.'⁷¹⁵

This statement is perhaps not surprising since the government is lobbied heavily by the franchisor-dominated industry group at the same time that there is no franchisee group to lobby on behalf of franchisee interests. This dissertation has demonstrated the conflicts of interest in the franchise relationship. Franchisors cannot be relied upon to look after franchisee interests. As Procassini points out in his study of trade associations, however,

'a cooperative rather than a confrontational approach is the most productive...Not only is this important within a sector, but it should be carried through to other interest groups...the cooperative attitude may not necessarily help in reaching a solution to differences, but confrontation will definitely hinder any near-term solution, and possibly negatively affect future solutions.'⁷¹⁶

The protection of a franchisee is the overarching purpose of the Franchising Code of Conduct. Addressing the imbalance of power and increasing certainty are among its stated goals. The government's choice of phrase, that it 'would not directly oppose' a franchisee representative body, however, highlights the government's lack of support for such an organization, probably because politicians do not want to be seen to favour policies opposed by the influential FCA. Franchisees' participation to become more involved and to play a greater role in the process of regulating franchising needs government support, support that, for whatever reasons, currently does not exist.

⁷¹⁵ The Australian Financial Review - ABIX via COMTEX, Jun 19, 2006. Sent to ABA listserv by Paul Steinberg.

⁷¹⁶ Andrew Procassini, *Competitors in Alliance* (1995) 305.

7.2.1.3 The role of the regulator in enhancing franchisee participation

If it imposes rules without the benefit of full participation, the regulator forfeits the opportunity to ensure appropriate regulation, and may hamper the healthy development of the sector. In the new participative, democratic and responsive conceptions of regulation the regulator-as-rule-maker model is replaced by regulator-as-facilitator-of-process. This regulator oversees and coordinates regulation at every level, through the operation of the market, the parties' agreements, court interpretations, and, if necessary, through legislation. Black writes that,

‘The dominant call is to develop procedures and institutional structures that will enhance deliberation and enable participation. Associated is the demand for regulation to shift from strategies of command to strategies of inducement, and for regulators to move from rulers to supervisors.’⁷¹⁷

Instead of command-and-control, a participative process offers an alternative to the regulator to the role of imposing rules, allowing it to more fully involve a franchisee and to better assist all stakeholders in the development, enforcement and monitoring of regulation. The role of the regulator becomes one of mediator of process in a reflexive regulatory system.

For the regulator a shift in emphasis from command to inducement to facilitation, from ruler to supervisor to servant/enabler of process does not mean a reduced role, but rather a more multi-faceted one. The inclusion of a wider range of stakeholders creates multiple roles for the regulatory agency such as that of catalyst, facilitator, mediator, endorser, broker, and provider of framework rules and regulatory support.⁷¹⁸ If self-regulation is hampered by a lack of necessary expertise, a regulator can supply this. Though it may be ill-equipped to evaluate when to intervene in some forms of self-regulation that are already functioning in any given situation, such evaluation can be made cooperatively, taking into account the interests of all stakeholders at all stages through the various layers. The regulator plays a coordinating role in ensuring the appropriate forms and levels of regulation for the particular industry context. Regulators can assist participation by designing and facilitating procedures whereby efficient and effective regulation of the franchise industry comprehends and involves the interests of all stakeholders at all stages.

⁷¹⁷ Julia Black, ‘Proceduralising Regulation: Part I’ (2000) 20 *Oxford Journal of Legal Studies* 597.

⁷¹⁸ International Policy on Industry Self-Regulation, Australia, Appendix D, <http://www.treasury.gov.au/documents/1123/HTML/docshell.asp?URL=appd.asp> at 20 July 2007.

To achieve this model it is necessary to revise the role of the regulator and the relationship between the regulator and stakeholders. The Australian Competition and Consumer Commission (the ACCC) is the agency charged with administering and enforcing the Franchising Code of Conduct.⁷¹⁹ The ACCC has experimented with regulatory alternatives. It has consulted with the community in efforts to test and review their performance, and it has responded to a number of perceived deficiencies. The fact remains, however, that the role of the regulator currently resembles the ‘command-and-control’ model of regulation albeit with the heavy participation of the trade association. Though a consultative panel meets periodically, there is not a transparent or regular process; and while several franchisor representatives and their trade association are always represented, meetings can be held with little or no representation of franchisee interests.

Franchisees lack power at every stage of the franchise relationship, in the self-regulatory layers of market and contract and in the co-regulatory initiatives of the ACCC. Non-participation in regulatory processes contributes to the ‘infantilization’ of a franchisee not only by a franchisor but also by the regulator. Franchisees’ interests are a stated priority; the protection of a franchisee is the overarching purpose of the Franchising Code of Conduct. Yet regulation of the sector in Australia has benefited from only minimal input from franchisees to inform whether statutory regulation is effective, whether it should be adjusted or reduced, and/or what further measures may be needed. There is in Australia, as there has been in America, a ‘conceptual disconnect between regulators and franchisees.’⁷²⁰

7.2.2 Meaningful measurements, identifying problems and selecting tools

This chapter has outlined the importance of Sparrow’s third ‘core element’ which is investment in collaborative process. The other elements are carried out through this

⁷¹⁹ Original proposals envisioned a new, separate administrative body to oversee the Code. Such a body was not set up. As the regulatory agency charged with administering the Trade Practices Act (TPA) the ACCC administers and enforces mandatory industry codes established pursuant to s51AD of the TPA, unless the enabling legislation provides otherwise. The functions of the ACCC encompass law enforcement and information dissemination. Subject to external review by Courts, Tribunals, Parliament, independent reviews and the Commonwealth Ombudsman, the ACCC handles inquiries on all aspects of the Code; it is responsible for education about and enforcement of the Code, as well as many other federal regulations that affect franchising, such as consumer protection and competition law.

⁷²⁰ Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn State Law Review* 105, 311.

collaborative process. Reframing starts with investment in collaborative process. That process informs better measurements and information and follows through with the use of these measurements in the systematic identification of problems and the selection of tools to address them.

Any regulatory program requires meaningful, accurate and reliable measurements to inform its process. Reframing regulation of franchising toward process requires obtaining meaningful measurements to systematically identify problem(s) that need to be 'fixed'. Without good information it is not possible to formulate objectives, or to select appropriate tools. As Chapter Three explained, obtaining accurate and reliable data about the franchise sector is a major challenge in the regulation of franchising, an ironic state of affairs given the central role of disclosure in the regulation of franchising.

Perhaps the greatest challenge in franchising regulation, then, is to remedy this insufficiency, and to put in place processes to ensure that reliable, objective information is available, not only to inform the participants at one stage of the relationship, but to inform regulatory process at all levels.

7.2.2.2 Identifying problems

Sparrow's prescription for improving regulatory process requires the systematic identification of problems and expanded use of tools. While this dissertation refutes the hypothesis that the Code is effective in the limited sense of not achieving some of its goals, it has not evaluated the appropriateness of these goals. It suggests ways that goals might better be met, but it also leaves open the possibility that, through participative and democratic process, the existing goals may be replaced by new goals that are better tailored to the realities and needs of the sector. What this dissertation does argue is that the identification of problems must be part of a process that fully includes all stakeholders.

7.2.2.3 Collaborative process to enhance the effectiveness of regulation

The regulation of franchising is low intervention; it relies heavily on self-regulatory methods, such as the parties' self-regulation through contract and disclosure. This dissertation has demonstrated that self-regulatory mechanisms that operate through market, contract and disclosure have not met the stated goals of regulatory intervention. The best way to ensure that the most appropriate regulatory tools are

selected, however, is to ensure proper regulatory process at all layers of governance. This is not proposed as an easy alternative. The measures discussed in this chapter are not intended as a prescription, but as a starting point for the involved process of collaboratively generating new ideas about how the goals for regulation of franchising can better be met,

‘Regulating conduct directly, rather than taking the easy approach of demanding more and more disclosure, requires far more thought and analysis of difficult questions on their merits.’⁷²¹

It is, however, precisely the fact that regulation is complex and difficult that makes the process of such critical importance. There are many ways, however, in which collaborative process that fully includes all stakeholders can lead to improved regulatory alternatives in the market, in contract and in direct intervention.

Collaborative process can enhance the role of franchisees in the market interaction. Reframing of franchisees’ roles in the market interaction can take several forms. As Chapter Three outlined, a franchisee’s role is a complex mix of investor, employee, consumer, licensee among other roles, most of which are not those of equal participants in a business venture with a franchisor. Franchisees need to understand the importance of their own participation and that their power potential is derived largely from their numbers in association. Together franchisees can help each other to understand that their participation is indispensable to the franchise system.

Collaborative process can be useful in providing information about reputation. It has several advantages over the prescribed disclosure process in that it is not mandated by legislation; there is no guesswork about what items of information need to be disclosed; it is cheaper; and there is greater legitimacy because of participation of the parties who use the information.

Other tools that might be used could include franchisee evaluations of franchisors. Such evaluations could be instituted as part of management processes. A franchisor might also provide a preliminary self-evaluation and would have an option to address the results of franchisee evaluations. Franchisee exit surveys could be used to provide information about why former franchisees have left the system, how problems were

⁷²¹ Susanna Kim Ripken, ‘The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation’ (2006) 58 *Baylor Law Review* 139, 148-149.

addressed, levels of satisfaction over time, and overall evaluations of the franchise experience without compromising confidentiality of dispute resolution procedures.

In many ways, prior to signing the contract, a franchisor needs franchisees more than any individual franchisee needs a franchisor. Once the contract is signed, a franchisee becomes dependent on and subordinate to a franchisor.

Collaborative process can also enhance the role of franchisees in the contract layer of governance. Franchisors, not surprisingly, resist the idea of collective initiatives of franchisees in contractual relationships. Michael Seid, franchise consultant and author of *Franchising for Dummies*, writes,

‘Franchising is a relationship between a franchisor and its franchisee. It is not a communal contract nor should it be. Granting the right or requiring collective bargaining has crippled US industry as we now know. It has not done too well in France or elsewhere in Europe or in any of the first world markets. I would hate to see unionism find its way into franchising as it certainly would suffer dramatically.’⁷²²

As Chapter Two outlined, collaborative process involves all stakeholders working together to identify and address the issues in the sector. While collaborative process covers a broad spectrum of activity, however, it is not the same thing as collective bargaining. In fact, collaborative process can vitiate the need for collective bargaining.

Collective bargaining suggests adversarial rather than collaborative proceedings, a tool that is necessitated by the breakdown in communication between franchisors and franchisees. It is probably not the most useful or appropriate method of initiating communication about issues in the franchising relationship.⁷²³ A collaborative approach to regulation is thought to be more inclusive than government intervention alone, to better represent stakeholder interests, and to offer a better chance of finding

⁷²² Email sent by Michael Seid to the author 22 June 2006.

⁷²³ See Robert Emerson, Franchising and the Collective Rights of Franchisees, 43 *Vanderbilt Law Review* 1503 (1990) Emerson lists five reasons: ‘First, most franchisees are not in the same legal or economic position as employees... Second, franchisee collective bargaining requires adequate safeguards, such as detailed and explicit legislative pronouncements. Otherwise, such rights -- by analogy or other creative legal interpretation -- could be used to alter, perhaps without any foresight, the law in many other areas... Third, there is very little history of franchisee-franchisor collective bargaining... Fourth, from both the franchisor's and franchisee's viewpoints, the use of franchising stems from legal, economic, and social considerations that run counter to those represented by a collective bargaining approach. ...Fifth, collective bargaining may foster or exacerbate an unduly adversarial approach to franchisee-franchisor relations.’

a solution, with the possibility of collective bargaining to motivate some franchisors to engage in collaborative process.

Clearer specification of criteria, conditions, rights of both parties is probably also best accomplished through collaborative processes that could be applied in scope of grant; for franchisee to exercise right of renewal; supply; and amounts to be paid if a franchisor's conditions damage a franchisee financially or put a franchisee out of business.

Collective and collaborative initiatives can be used to establish greater reciprocity of obligation in areas such as scope of grant and the lack of restriction on franchisor encroachment as compared with restraint of trade clauses; minimum performance; and transfer.

An interesting development from the US is the recent collective negotiation by franchisees with Culligan International. To achieve their goal of aligning interests and addressing issues that had strained a franchisor's relationships with its franchisees, franchisees collectively determined that,

'If they could not persuade their new franchisor to make significant concessions, they would leave the franchise system en masse and found a rival water treatment company of their own. ...The resulting new agreement "reflects more of a true partnership, with shared decision-making, mutually supportive financial goals and, perhaps most importantly, mutual respect". ...[it] features shared commitments, responsibilities, and rewards, a departure from many franchise agreements designed to give the franchisor firm control over the business...Under the revised terms, franchisees who previously had little clout – something common in many franchise systems – now must be consulted on critical changes to the brand and hold some veto power.'

The new contract provides for a duration of 20 years (twice the length of previous contracts); a franchisee right to renew; franchisor consultation with franchisees on major changes to the business; reduced prices on current equipment supplied by the franchisor; franchisee approval of franchisor suggested retail prices; franchisee freedom from franchisor examination of customer lists; exclusive territories; and elimination of franchisor right of first refusal with respect to franchisee transfer.⁷²⁴

⁷²⁴ Thursday, November 16, 2006, Culligan's New Franchise Agreement Reflects "True Partnership"
This posting was written by Peter Reap, editor of CCH Business Franchise Guide
<<http://traderegulation.blogspot.com/2006/11/culligans-new-franchise-agreement.html> at 1 December 2006.

Collaborative initiatives can help address imbalance of power in the relationship and lack of negotiation of the contract engendered by the standard form, as well as the problems engendered by relational contracting, such as the need for flexibility and the concomitant uncertainty that this can create for franchisees. As the non-drafting party, a franchisee needs a vehicle to re-enter the process of design, drafting and negotiation of the standard form product. Franchisees that, because of the standard form nature of the contract, cannot negotiate can be assisted through collective initiatives in negotiating with franchisors as well as education to improve their awareness of alternatives in the market. A process of consultation between franchisors and franchisees can reduce the one-sided, command-and-control qualities of the standard form that are inconsistent with the flexibility, cooperation and trust central to the successful function of a relational contract. It can also help establish greater certainty for franchisees, without sacrificing uniformity and control that are central to the success of the sector.

Collaborative initiatives to engender understanding of contract terms work best where there is a 'contracting community' and repeat transactions occur on both sides. The contract then becomes well-known and understood throughout the sector by franchisees. In franchising, while the contract is widely used, it is only used repeatedly by franchisors; a franchisee typically enters such a contract on a one-time basis. This measure might be effective, however, where franchisee organizations are in place to act collectively as one side of the 'contracting community'. This might seem like collective bargaining, but the focus of collaborative process can defuse the antagonism and enable mutually beneficial results.

Collaborative participation that includes collective negotiation of certain contract terms need not unduly threaten uniformity. A crucial factor in the continued success of franchising into the future will be its ability to achieve a high level of uniformity through means other than command-and-control.⁷²⁵ As the sector matures and our understanding of the role of uniformity in franchising develops, perhaps we can afford to take a more nuanced view. Variations in the franchise contract will not

⁷²⁵ See Sanja S. Mehta and Lou E. Pelton, 'Limitations of Existing Theories: A Need for "A General Theory of Franchise Relationships"' (Paper presented at the 14th Annual International Society of Franchising, San Diego, February 19-20, 2000) for a discussion on interdependence theory, replacing command and control governance by franchisor. Another option is to select another organizational form. In cases where a franchisee must be treated differently for the system to survive (consider the Kodak model in China) then a distributorship arrangement may offer advantages.

always jeopardize the type of uniformity of operation that strengthens brand, especially if negotiation is conducted collectively. A franchisor might well be less concerned about uniformity in some contract terms than others.⁷²⁶ Some parts of the contract may indeed be non-negotiable, even collectively, but other aspects of the contract might still be adjusted for the improvement of the relationship and the system overall.

Franchisee participation of this kind mitigates the one-sidedness that allows unfair contract terms to persist, and can enhance the role played by franchisees without compromising uniformity in the contracts. Greater participation by franchisees in the drafting of the agreement can also enhance understanding of the relationship and so help to build trust.

In theory the contract is a tool for monitoring by a franchisee to protect against a franchisor's abuse of control over assets provided by a franchisee.⁷²⁷ In practice, however, the contract and the structure of the relationship make a franchisee's task of monitoring more difficult than that of a franchisor in monitoring a franchisee. The contract written by a franchisor provides for monitoring by a franchisee only in limited ways. Blair and Lafontaine predicate the ability of a franchisee to check franchisor opportunism of franchisee awareness of that opportunism, and 'public knowledge', conditions that at present are in short supply.⁷²⁸ For this reason franchisees' effective monitoring of a franchisor can be significantly improved through collective involvement of franchisees.⁷²⁹

Collaborative participation, franchisee advocacy groups, and other methods of stakeholder involvement in sector regulation hold promise also for improved judicial

⁷²⁶ According to a recent study in the US based on a sample of 170 franchise contracts, contract terms in franchising were often determined in a haphazard way. Franchisors identified a few key requirements but commonly left much of the contract to be filled in with precedent. Imitating what other franchisors have done might not be the best solution for their situation. In one case a franchisor copied another major franchisor's policy regarding exclusive territory, not realising that the provision had resulted in chronic litigation for the first franchisor.

⁷²⁷ B. Elango and V.H. Fried, 'Franchising Research: A Literature Review and Synthesis' (1997) 35(3) *Journal of Small Business Management* 68, 74.

⁷²⁸ Roger Blair and Francine Lafontaine, *The Economics of Franchising* (2005) 218.

⁷²⁹ Jim's franchise system contracts are unusual in providing a franchisee greater means of supervision over a franchisor's behaviour, for example representation by franchisees on a board, and a council of franchisees to review franchisor.

interpretation of the contract. There is a role to play in the negotiating process, in education, monitoring, enforcement, and in informing and structuring change.

Cooperation and consultation among franchisors and franchisees, for example to formulate appropriate terms for both franchisor and franchisee to maximize returns; in making business plans; in matters involving supply such as measures that allow franchisees to play a role in negotiating supply contracts; in franchisee buying cooperatives for larger systems, along with a franchise contract that authorizes franchisee to shop from among several franchisor approved suppliers; and in setting minimum performance standards that are more about a process that includes franchisees than about a franchisor unilaterally setting arbitrary standards which, if a franchisee fails to meet, constitute grounds for termination. Finally, there should also be consultative processes for amendments to the system; the contract should ensure a franchisee's involvement in the process.

7.2.2.4 Expanding the range of tools used in direct intervention

Direct intervention is another layer of governance through which the roles of participants can be revised and enhanced. The need for a reframing of the roles of participants in the design of regulation was outlined at the start of this chapter. The following section outlines some ways that collaborative process can provide better results in the selection of appropriate tools for use in direct intervention.

In many countries with sector-specific legislation for franchising, as in Australia, such legislation features disclosure. Disclosure is a procedural requirement, probably the most widely used tool in the regulation of franchising internationally. Along with mandatory mediation it is the principal tool used in the regulation of franchising in Australia. As such it has been discussed at length in Chapter Six.

Disclosure and other regulatory tools that may not perform optimally can be adjusted to improve results. Chapter Six outlined some of the ways the function of disclosure can be enhanced, such as by better information from franchisees and franchisors about the nature of franchising generally including fuller representation of stakeholders on consultative panels; expansion of legitimate, independent research initiatives that include studies and surveys that accurately reflect all stakeholders' interests; improving the quality, the timing and presentation of information made available to franchisees as well as education about and monitoring and enforcement of disclosure

provisions; registration of disclosure documents; systematic monitoring to ensure reliable information about particular franchise systems and in some cases more specific information such as more detailed information about payments, earnings, intellectual property, and tenancy; consistency with other regulation, such as TPA section 52; greater transparency of process; and more complete information from dispute processes.

Some of these measures to improve the function of disclosure can be conducted through collective and collaborative initiatives. Collaborative initiatives have the potential to improve dissemination of information generally, to ensure better franchisee education programs, to supply information about the general nature of the franchise relationship and the franchise agreement and to promote wide use and understanding of contract terms. Collective initiatives could also provide a source of information to prospective franchisees about franchisor reputations. All these measures could also help to provide more meaningful measurements to inform regulatory process generally.

Improvement to disclosure, however, is only one small measure towards better regulation, and it does not address the systemic problem. Current theories of regulation and formulations of best practice require that regulatory process comprehend the dynamics and interactions among a versatile range of regulatory tools and that it take advantage of synergies among these tools to achieve regulatory objectives.⁷³⁰ Instead of relying on a very limited number of tools whose efficacy is unproven, regulators could, through a participative process, choose from a full range of regulatory instruments.

Most jurisdictions that use disclosure as a regulatory tool also employ other tools. In some jurisdictions disclosure is not relied upon so heavily and other tools are used in lieu of disclosure.⁷³¹ The following sections describe some of the tools that are used in the regulation of franchising in various jurisdictions. These tools fall into three categories, prescriptive standards, procedural regulation, and performance standards.

⁷³⁰ The work of Hugh Collins; Julia Black; Gunningham and Grabosky; Martin and Cave; and Baldwin, Scott and Hood; among others support Malcolm Sparrow's call for the expansion, diversification and improved calibration in the use of regulatory tools

⁷³¹ Legislation and Regulations Relevant to Franchising, Annex 3 to the UNIDROIT, *UNIDROIT Guide to International Franchise Arrangements* (1998) UNIDROIT periodically updated at: <<http://www.unidroit.org/english/publications/franchising/1998guide/main.htm>> at 31 December 2005.

Prescriptive standards mandate certain requirements, methods, or techniques and include mandatory warranties; confidentiality requirements; and prescription of the contents of the contract including specification of unfair terms, mandatory contract duration, and good faith requirements. Prescriptive regulation may also prohibit certain practices. In principle prescriptive standards may be incompatible with self-regulation; because they are often quite specific and are viewed as requirements imposed on the sector rather than undertaken voluntarily, they tend to engender attitudes of ‘creative compliance’ rather than to encourage business to move beyond compliance.⁷³² They are, nevertheless, widely used in franchise regulation. Procedural standards are often used where measurement is difficult; they include, for example, licensing and specified procedures for the parties’ interactions during contract formation and/or performance, such as disclosure. Performance standards define the regulated interest’s responsibility in terms of the goal to be achieved; they include requirements of certain levels of performance of a franchise business before it can sell franchise units.

Content control

Content control generally refers to regulatory requirements of the content of contract documents; it is a prescriptive regulatory tool used in many jurisdictions that regulate franchising. Australia proscribes general indemnity of franchisor by franchisee. Albania and Lithuania require that the contract be in writing.⁷³³ Indonesia, Malaysia, and Italy prescribe a contract minimum duration of five years, five years and three years respectively. There are prohibitions on vertical restraints in Australia, Japan,⁷³⁴ the European Community, and the US.⁷³⁵

Some types of content control legislation have traditionally been limited to consumers, and only rarely extend to the protection of commercial actors. Content

⁷³² Gunningham et al, *Smart Regulation: Designing Environmental Policy* (1998) 387-422.

⁷³³ Legislation and Regulations Relevant to Franchising, Annex 3 to the UNIDROIT, *UNIDROIT Guide to International Franchise Arrangements* (1998) UNIDROIT periodically updated at: <<http://www.unidroit.org/english/publications/franchising/1998guide/main.htm>> at 31 December 2005.

⁷³⁴ In Japan if restraints go further than necessary to operate the franchised business, they may constitute abuse of a dominant position, as a tie-in, as dealing on restrictive terms or as retail price maintenance.

⁷³⁵ Many jurisdictions impose these requirements through in competition law rather than franchise specific legislation. Legislation and Regulations Relevant to Franchising, Annex 3 to the UNIDROIT, *UNIDROIT Guide to International Franchise Arrangements* (1998) UNIDROIT periodically updated at: <<http://www.unidroit.org/english/publications/franchising/1998guide/main.htm>> at 31 December 2005.

control provisions are commonly used to regulate standard form contracts, to protect the interests of the weaker party, which has not had the benefit of the process of negotiating contract terms, and in recognition of the overriding separation of parties' interests.⁷³⁶

Specificity is one strategy for dealing with some of the problems of the standard form. Collins suggests that legislation identify unfair terms,⁷³⁷ so that these terms amount to compulsory rules governing transactions with consumers in particular trade or sector.⁷³⁸ This measure effectively removes an aspect of self-regulation altogether as parties must conform to approved terms for the market sector. Collins says it does not matter if such a proposal destroys the market for contract terms in cases such as franchising because no such market exists to start with.⁷³⁹ He suggests that it is better to regulate market sectors such as franchising by bringing together the two sides of the trade to negotiate standard terms. Unfair terms legislation is used in consumer law applications in many jurisdictions, and could be one product of collaborative processes in the regulation of franchising. In the UK 'The Office [of Fair Trading] considers that a sectoral approach is the most cost effective method of bringing about change.'⁷⁴⁰

The standard form renders the consumer/commercial distinction less meaningful. . In the case of the franchise relationship the 'contract as commodity' of the standard form suggests that a franchisee takes on qualities of consumer of product, rather than an equal party to negotiation of terms. A franchisee as an investor needs one set of protections. A franchisee as a consumer needs others. The use of the standard form contract in franchising lends force to a franchisee's right as a consumer to reasonable quality, reasonable prices, and fair terms and justifies lawmakers' consideration of

⁷³⁶ 'From the previous analysis it results that, even if information regulation is the least interventionist measure and has the advantage to preserve the consumer's choice, it has some limits. Therefore, product standards are necessary in order to correct market failures arising from information deficits and externalities. ... When standards are not sufficient to correct market failures, prior approval might be used. To choose one of these techniques, it is necessary to assess their efficacy. Thus, the relevant question is: 'how much regulation is efficient?' See Alessandra Arcuri, *5130 Product Safety Regulation* (1999) <<http://encyclo.findlaw.com/5130book.pdf>> at 4 December 2006.

⁷³⁷ The European Directive on Unfair Terms in Consumer Contracts see 93/13 OJL 95/29 5 April 1993.

⁷³⁸ Hugh Collins, *Regulating Contracts* (1999) 236.

⁷³⁹ *Id.*, 234.

⁷⁴⁰ Iain Ramsay, 'Regulatory Capitalism and the 'New Learning' in Regulation', 28 *Sydney Law Review* 9 (2006).

content control provisions for select terms.⁷⁴¹ The fact that a franchisor is selling a product, a licence, and a franchisee is the consumer of that product, suggests that there should be some minimum protections for the consumer of that product. No jurisdiction, however, is known to have instituted warranties for the sales of franchises.

The exaggerated imbalance of power and uncertainty persist through the duration of the franchise relationship, so that regulation should address the power imbalance not only at formation, but also in the performance of the contract, as regulatory intervention has done in the case of consumer and employment contracts.⁷⁴²

The standard form contract is a fact of life; it is admittedly indispensable to the containment of transaction costs in repeated commercial transactions. Realizing this, regulators exercise caution in dealing with its abuses. They should balance this caution with the need to protect parties that are not sufficiently able to protect themselves.

Good faith

The use of content control as a statutory implied term of good faith is documented in Canada, Korea, and Albania.⁷⁴³ There is no such requirement in the regulation of franchising in Australia, though it is true that the degree to which parties act in good faith is one of the criteria for determining of unconscionable conduct has occurred under TPA Section 51AC. To bolster this provision a requirement of good faith also might be incorporated into unfair contracts legislation. In Australia good faith to some extent is implied in the contract, in the unconscionable conduct statute at the federal level and some state fair trading legislation. There have been several cases addressing good faith in the context of franchising. In *Burger King Corp v Hungry*

⁷⁴¹ For more on fair terms in contracts see John Tillotson, *Contract Law in Perspective* (3rd ed 1995) 121-124. For a discussion of content control in standard form contracts see John J. A. Burke, 'Reinventing Contract' (2003) 10(2) *Murdoch University Electronic Journal of Law* [51] <http://www.murdoch.edu.au/elawwithissues/v10n2/burke102_text.html> at 14 August 2003.

⁷⁴² Phillip P. Blumberg, 'The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities' (1996) 28 *Connecticut Law Review* 295, 344. Collective participation of franchisees also helps to ensure their protection, for example in the aspects of their role as employees. The situation in Australia is similar to that in the US where, 'Franchisors and franchisees which today represent a major segment of the American economy most strongly raise the issue of the application of enterprise principles to collective undertakings resting on contract.'

⁷⁴³ Legislation and Regulations Relevant to Franchising, Annex 3 to the UNIDROIT, *UNIDROIT Guide to International Franchise Arrangements* (1998) UNIDROIT periodically updated at: <<http://www.unidroit.org/english/publications/franchising/1998guide/main.htm>> at 31 December 2005.

*Jack's Pty Ltd*⁷⁴⁴ the court applied an objective standard in deciding that Burger King Corporation's actions were neither reasonable nor for a legitimate purpose. The court referred to the Restatement (Second) section 205 (1981) which provides: 'Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.' In *Dymock's Franchise Systems (NSW) Pty Ltd v Todd*,⁷⁴⁵ however, the court held that the express terms had imposed duties of cooperation which the franchisee breached, but did not say there was obligation of good faith,

'...In view of the continuing disagreement between the experts as to whether or not there is an obligation of good faith in a case such as the present, their Lordships also prefer the course of prudence and do not seek to answer the question since there is some other proper ground on which the appeal can be decided.'⁷⁴⁶

Australian courts thus have not determined that there is a general obligation of good faith in franchise contracts. A good faith requirement for the franchising sector was recommended by the 2006 Review of the Disclosure Provisions of the Franchising Code of Conduct, 'recognition in the Code of a concept of good faith and fair dealing would provide positive reinforcement to the development of improved relationships and dealings between franchisors, franchisees and prospective franchisees.'⁷⁴⁷ This recommendation was rejected by the government.

Procedural tools

The cooling-off period required at contract formation in Australia and Malaysia is a procedural regulation as are the transfer and termination procedures that are used in Australian regulation and that of some US states. Such procedures include termination safeguards and provide that a franchisor must not unreasonably withhold consent for franchisee to transfer a franchise. Other recommendations from Chapter Five included procedures for franchisor's changes to territory allocations, selection of franchisees, and matching franchisees to units and territories.

⁷⁴⁴ *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (see also *Hungry Jack's v. Burger King* [1999] NSWSC 112).

⁷⁴⁵ *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*, [2002] UKPC 50, [2004] 1 NZLR 289.

⁷⁴⁶ *Ibid.*

⁷⁴⁷ See Recommendation 25, the Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=6B99EC0B-BC2F-F60A-CD6A9D32E1031993> at 14 May 2007.

Dispute resolution

Dispute resolution procedures are also used such as mandatory mediation in Australia and Korea. In Australia, mediation is a Code-mandated dispute resolution procedure thought to engender greater participation by franchisees in conflict resolution, greater transparency of conflict processes, and assistance to parties in understanding and utilising conflict management procedures.

Other possible procedures include the used of an ombudsman, from the Swedish meaning 'go-between'. Traditionally used to represent citizens in disputes against administrative functions of government, ombudsmen now work in a variety of settings to provide a confidential, neutral and informal facilitation of equitable resolutions to disputes. The service provides a resource for information and communication, feedback, advice, and dispute resolution.⁷⁴⁸

Registration

There was a registration requirement for franchise systems in Canada (Alberta, repealed); this requirement is still in place in Malaysia, Spain, and some US states.⁷⁴⁹

Registration of intellectual property is required in Kazakhstan. Korea and Japan have registration requirements for franchise consultants or brokers.

(Registration of disclosure is discussed in Chapter Six)

Procedures for monitoring and enforcement

Some jurisdictions have set up a separate regulatory institution and/or a separate advisory entity for one or more functions. Malaysia has an advisory board and a special agency to oversee regulation.

Australia has a franchising consultative panel to enable the sector participants to consult with the regulator. There is, however, no prescribed procedure for monitoring the effectiveness of the Code in Australia. There are occasional surveys; in 2006 the

⁷⁴⁸ Christina M. Kuta, 'Universities, Corporations, and States Use Them Now It's Time To Protect Them: An Analysis of the Public and Private Sector Ombudsman and the Continued Need for a Privileged Relationship', 27 *Southern Illinois University Law Journal* 389 (2003).

⁷⁴⁹ State laws generally define franchising similarly to the FTC Rule, but differences between the states' definitions and exemptions can be crucial to determining whether a particular sale was or was not the sale of a franchise. California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oklahoma, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin require a registration or notice filing before offering franchises for sale, and pre-sale disclosure through twenty items in a prescribed format called a Uniform Franchise Offering Circular (UFOC). Also, Oregon requires pre-sale disclosure without a governmental filing. See Mark Miller, 'Unintentional Franchising' (2005) 19(2) *St. Mary's Law Journal* 308.

Minister for Small Business embarked on a Review of Disclosure as part of the regulation of franchising. Unfortunately, however, these reviews share the disadvantage of being limited in duration and scope, and based largely on surveys and anecdotal evidence. In addition, the processes are not transparent.

In the first nine years of the Code's operation the ACCC initiated litigation against franchisors under the Code in only fifteen cases.⁷⁵⁰ This may be due in part to the fact that there is little substantive regulation that can be breached. Also, with respect to the more self-regulatory aspects of the Code, such as disclosure and mediation, there is no monitoring of compliance.⁷⁵¹

The regulator could avail itself of a range of other analytic tools, including comparative risk assessment, cost-benefit analysis, and cost-effectiveness analysis to inform, monitor and assess regulatory activity; 'there is a broad consensus that [such tools] should be used to inform major regulatory decisions.'⁷⁵² An important indicator of the effectiveness of statutory regulation is its impact on market function. While it is difficult to measure the impact of regulation on the health of an industry, possible indicators might include prices, as in franchise fees, rents and royalties; trends in gross turnover; average length of the franchise relationship; number of franchise systems; and number of franchisee units, all of which must of course be adjusted for the effects of exogenous factors.

Regulation of any kind requires appropriate incentives and enforcement to ensure effectiveness. With respect to enforcement collaborative initiatives can help to ensure that regulation is indeed complied with. Several items of the 2006 Review of

⁷⁵⁰ D. Lynch, Strength in Numbers for Franchisees, *Australian Financial Review*, (2006, 20 June).

⁷⁵¹ The burden of identifying breach rests with franchisees. Their preference when taking legal action appears to be to rely on the broader provisions of the TPA section 52, rather than on the Franchising Code of Conduct. The majority of the franchising cases that are litigated involve breaches of the TPA section 52.

⁷⁵² Fred Anderson et al, 'Regulatory Improvement Legislation: Risk Assessment, Cost-Benefit Analysis, and Judicial Review' (2000) 11 *Duke Environmental Law and Policy Forum* 89. When multiple hazards are assessed within a common framework and combined into a single report, the phrase comparative risk assessment is used. Cost-benefit analysis is a tool developed by economists and scientists to determine whether a proposed course of action is efficient compared to alternative courses of action. In a cost-effectiveness analysis, the cost of a project is divided by a quantitative (yet non-monetary) measure of effectiveness, such as the number of years of human life saved or tons of pollution removed. The terminology, as defined above, is not universally accepted. Sometimes the phrase "risk analysis" is used as a broad umbrella to refer to all of these tools.... Risk assessment and cost-benefit analysis offer insight and intellectual discipline to the decision-making process. They can help to identify and evaluate decision options, and achieve more benefits at less cost than otherwise would occur.'

Disclosure were rejected by the government in part or in whole on the grounds that it would be difficult or inappropriate for the ACCC to enforce.

As the regulator is fulfilling a broad role with a limited budget, it makes sense to enable other stakeholders to assist with enforcement. If the administrative burden is too great for the ACCC, then, as Rubin suggests, the monitoring of franchisors may require collective action by franchisees.⁷⁵³

⁷⁵³ P.H. Rubin (1978), 'The Theory of the Firm and the Structure of the Franchise Contract', 21 *Journal of Law and Economics* 223.

Performance standards

Romania has minimum qualifications for franchisors.⁷⁵⁴ Fiscal solvency requirements must be met before registering franchise offerings in the US state of Virginia.⁷⁵⁵ Minimum qualifications or accreditation are imposed in Korea for franchise transaction consultants. Another performance requirement that has recently been promulgated in China and in Vietnam is that a franchise system must operate a certain number of pilot units for a certain number of years before it can sell franchise units. In China the requirement is the operation of at least two units for one year.⁷⁵⁶ In Vietnam a franchisor must have a store in operation for one year. In Italy there is a requirement that the franchise concept must be tested in the market prior to the sale of franchise units. These measures are similar in effect to accreditation but the focus is on performance rather than procedure. Performance standards for franchising might also include Codes of Ethics and/or Practice, as used in New Zealand and the European Community. There may be a greater role for performance standards, or perhaps procedures to enable performance review. Again, there is overlap here with procedural standards such as the prescribed procedures for dispute resolution and termination.

7.3 CHAPTER CONCLUSION

Over a 30-year history of experimentation with the regulation of the franchise sector in Australia, regulators have preferred low-intervention, self-regulatory instruments with the participation of the trade association. As Chapter Two's review of the evolution the current regulation of the franchise relationship in Australia indicates, regulation of franchising has in many respects been inconsistent with best practice. This chapter proposes an alternative to current regulatory process for the franchise sector in Australia, a reframing of regulation.

Because the problems of imbalance of power and uncertainty are pervasive, because the role of a franchisee has been so fundamentally marginalized, any effective

⁷⁵⁴ Legislation and Regulations Relevant to Franchising, Annex 3 to the UNIDROIT, *UNIDROIT Guide to International Franchise Arrangements* (1998) UNIDROIT periodically updated at: <<http://www.unidroit.org/english/publications/franchising/1998guide/main.htm>> at 31 December 2005.

⁷⁵⁵ The laws of individual US States are not considered in this table at the time of this writing, with this exception. For more information on this requirement, please refer to the Division of Securities and Retail Franchising, Virginia State Corporation Commission.

⁷⁵⁶ Andrew Terry, 'A Census of International Franchise Regulation', Paper Presented at the 21st Annual International Society of Franchising Conference (2007).

regulation of the sector must first ensure that it no longer excludes a franchisee at every stage in the regulatory process and in every layer of regulation. What is most needed is a return to the fundamental process of regulating, a process such as that prescribed by Sparrow that is democratic, responsive, and participative. This chapter describes the benefits to the sector of collaborative initiatives in regulating. There are significant barriers to such initiatives; this dissertation suggests that a realignment of interests and roles among all stakeholders will be required to institute the needed changes.

With respect to measurement information about what is happening in the sector must be sourced in a balanced way from all participants. Using this information, the stakeholders/participants are in the best position to identify problems in the sector. With respect to tools this dissertation outlines some alternatives and describes a broad menu of tools that can be employed to regulate the franchise sector. Here again stakeholders/participants should be involved in the process with the regulator.

Reframing regulation would facilitate revision of patterns in the process of regulation and in the reviews and revision of this process that have grown stale, allowing regulatory practice to more closely resemble the 'new learning' of regulatory theory. As it requires better measurements and information, reframed regulatory practice will fit more closely the needs of the sector and have greater legitimacy, accountability and responsiveness. Broader involvement of stakeholders will likely lead to better information and measurements, more accurate identification of problems and the more effective use of wider range of tools.

Finally, as it will fully enlist the participation of all stakeholders, franchisees as the protected interest will be better represented to the regulator and in every aspect of the governance of the relationship thereby correcting rather than contributing to the imbalance of power and uncertainty within the very process of regulation at all levels. The regulator needs to work together with all stakeholders so that all participants better understand the deal and the true nature of the risks and rewards of the interaction. Then there will be fewer franchisee complaints, fewer news stories and less need for inquiries into why regulation does not seem to be working.

Finally and fundamentally, franchisee involvement can help to unify the sector and its image and to prevent schisms from within that threaten the competitiveness of the sector as a whole.

7.4 CHAPTER SUMMARY AND RECOMMENDATIONS

This chapter has summarized the conclusions of this research and has explored some strategies for reframing the regulation of franchising. The main points and recommendations are as follows:

- In the franchise sector self-regulation not only sets up but reinforces conditions of imbalance of power and uncertainty for a franchisee. Regulatory intervention is often used to address inefficiencies and inequities in market interaction and other layers of governance. The current regulatory strategy, however, is not meeting its stated goals. Imbalance of power and uncertainty persist in the franchising relationship. Franchisees are marginalized at every stage of regulatory process.
- It is therefore necessary to explore alternative approaches to governance that can help to ameliorate the problems of imbalance of power and uncertainty in the franchise relationship.
- The most important element is collaborative process, to reframe the roles of franchisee, franchisor and the regulator consistent with the ‘new learning’ about regulation that features participative, democratic process.
- Regulation of franchising should be reoriented toward process through collaborative approaches to meaningful measurements, identification of problems and selection of tools. This is the avenue to a regulatory process that is most likely to redress imbalance of power and uncertainty for a franchisee because it addresses these problems structurally in every layer of regulation.

Chapter Eight

Epilogue

‘...things must happen when it is time for them to happen. A quest may not simply be abandoned; unicorns may go unrescued for a long time, but not forever; a happy ending cannot come in the middle of the story.’⁷⁵⁷

The importance of ‘a fair go’ is a value we teach our children at an early age, but one we sometimes neglect as adults. A ‘fair go’ is a hallmark of Australian cultural values, and the assurance of fair practice is also an essential component of competitive, efficient markets.⁷⁵⁸ This dissertation began with the premise that in Australia there is evidence of franchisee dissatisfaction and of conflict between franchisors and franchisees that warrants a closer look at the franchise relationship and at its regulation. Franchising makes an important contribution to the economy of Australia, as it does to the economies of many countries, but there is reason to doubt whether the franchise sector in Australia is as efficient and competitive as it might be. Appropriate and effective regulation of the franchise sector can make it fairer and so should enhance its competitiveness. The question this dissertation has sought to answer is whether the regulation of the sector is effective in achieving its stated goals, in balancing power and in enhancing certainty for franchisees so that the sector is fairer and so more competitive.

An issue that quickly emerges in evaluating the effectiveness of the Franchising Code of Conduct is the lack of reliable information about the sector. There are no baseline measurements. There is no hard economic data. There are many reviews and surveys, but questions must be posed as to whose opinions they reflect and who pays for and publicises them. When independent research is carried out, questions again must be asked about who is paying for that research, and equally, who is paying to discredit it.

⁷⁵⁷ Peter S. Beagle, *The Last Unicorn* (1991).

⁷⁵⁸ The purpose of the Trade Practices Act is ‘to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.’ Louise Sylvan, ‘Advancing Australia Fair and Competitive!’, Speech given at the Law Institute of Victoria (2004) <http://www.liv.asn.au/media/speeches/20040226_acc.html> at 15 June 2006. See also M. Porter *The Competitive Advantage of Nations* (1990) discussed in Chapter Two.

This dissertation addresses the lack of information, first by identifying the problem, and second, in order to clarify some of the mystery surrounding the franchise relationship, by looking to the contract for evidence as to whether regulation achieves two of its stated goals, redressing imbalance of power in favour of a franchisor and reducing uncertainty for a franchisee. The analysis evaluates whether the contract terms indicate that these goals have been reached. If they do, then regulation is achieving those goals and to that extent it is effective. Because the contract terms reflect imbalance of power and uncertainty, the results indicate that regulation of the franchise relationship is not achieving the stated goals of the Franchising Code of Conduct.

This dissertation, however, does not simply consider regulation in the sense of direct intervention. Concepts of regulation have changed; regulation is now conceived in the broad sense of governing, through multiple layers, privately by the parties themselves as well as through public means such as legislation. While the goals being evaluated are the stated goals of the Code of Conduct, this research looks at how these conditions are influenced by regulatory measures at all layers of governance.

At a fundamental private layer of regulation franchisors wield the power in the market interaction. It is axiomatic that knowledge is power. Franchisors and their trade association have the knowledge, but, because their first priority is to ensure that franchisees will want to buy what they have to sell, they do not always make available reliable, accurate information about the sector. Publicity of the risks and problems in the sector would render their product less attractive, and would directly impact on the franchisor bottom line, so franchisors and their trade association spend significant resources in marketing not only their systems, but the business form, and in ensuring that any information that might cast a shadow over the sector is not made public or, if it is, that it is discredited. Franchisees lack the power of knowledge in the franchising relationship largely because franchisors and their trade association make it their business to only selectively inform them. Franchisees who try to inform themselves are discouraged by the many obstacles to unified communication, including threats of defamation; risk of breaching anti-trust provisions such as primary boycott; franchisor claims of lack of good faith; and their own independence; even their own industriousness. Other potential sources of information

also fall short, for example, information about dispute processes is unavailable because, for reasons of confidentiality, the Code-mandated process of mediation is opaque. At the market layer of governance, franchisees are at a fundamental disadvantage because of their lack of information as well as other factors that can include inexperience, lack of expertise, isolation, lack of expert advice and modest financial resources. Self-regulatory mechanisms such as markets for terms or dispute resolution systems, negotiation, and collective knowledge are ineffective at addressing the goals of regulation at this layer of governance.

At a second private layer of governance, contract, franchisors again dominate the interaction. Franchisors' solicitors draft the standard form franchise contract to provide wide latitude to the franchisor and to reflect its interests. The contract gives a franchisor extensive discretion, few obligations, and few limitations, such as the occasional reasonableness requirement. Even then, some contracts include a collective agreement clause that allows a franchisor to change the terms of the deal unilaterally at its discretion. Franchisors profit from selling the rights to use intellectual property in a certain location for a certain period of time. They strictly control the use of that intellectual property. They dictate the terms of the relationship and the operating procedures of franchisees. They require franchisees to buy services and supplies that increase their own revenues, and collect marketing funding from franchisees that they spend at their discretion. They have access to franchisee computer systems and premises, often control leases, own goodwill and impose extensive conditions on franchisee transfer. They calculate franchisee profits, potentially to the narrowest of margins. As if all this were not enough, contracts are written to accord a high level of discretion to a franchisor that spells uncertainty for franchisees. The contract as a means of redressing imbalance of power and uncertainty for a franchisee is also ineffective.

Private governance through market and contract is not only ineffective at achieving the stated goals of regulation, but in fact it sets up and reinforces imbalance of power and uncertainty in the franchise relationship. Therefore, private governance cannot be regarded as a means to cut costs and to leave the sector to take care of itself. Public regulation, in the form of statutory intervention, also has not solved the problems in franchising. The historical development of direct intervention in the franchise sector in Australia has been largely politically-motivated, employing

processes that are insufficiently transparent and accountable. Regulation of the sector has not been informed by the measurements needed to determine where the problems lie. Nor has it systematically identified problems in the sector, and expanded the range of tools available to address them; instead it relies heavily on the trade association model of regulation and self-regulatory tools which one of the parties is poorly equipped to use. Even though it has consulted with the industry, it has not invested in fully-inclusive, collaborative partnerships to inform a shared purpose and enhance legitimacy throughout the process.

Direct intervention was not the product of collaborative procedures to collect accurate data, systematically identify problems and select the appropriate tools. Instead, the Franchising Code of Conduct borrowed substantively from US legislation and was modelled on a style of regulation that is being revised in the UK. Consisting of several substantive provisions,⁷⁵⁹ and disclosure and mediation, the Code relies principally on the latter two self-regulatory tools without ensuring, in light of the imbalance of power in the relationship, that both sides of the relationship are represented and able to fulfil their roles in these self-regulatory procedures. The analysis of direct intervention in this research has been focused primarily on disclosure. Disclosure does not work because the information provided may be inadequate and because franchisees are not able to use what information they do receive. Franchisees are unable to play their role in disclosure, just as they are marginalized throughout the various layers of the regulatory process, and indeed throughout the various stages of the franchise relationship. When one looks at the governance of the relationship at every layer, it is difficult to see how the low-intervention, self-regulatory tools of disclosure and mediation can effectively address such deeply ingrained and systemic problems.

Franchisors have an interest in keeping regulation low-intervention and self-regulatory, and it is their voice that is heard by the regulator. Franchisors participate in direct intervention to a much greater degree than franchisees. They are well-represented to the regulator through their trade association. Franchisees are not usually members of this association and do not have their own association.

⁷⁵⁹ As shown above these substantive provisions are as follows: a cooling-off period for franchisees, signed statements that a franchisee has been given advice, or has been told to seek advice but has decided not to seek it prior to signing the franchise contract, no general indemnity of franchisor by franchisee, no prohibition on franchisees' freedom to associate with other franchisees, and some procedural provisions with respect to transfer and termination.

Franchisees encounter major barriers in communicating among themselves; there seems little hope that they can get together to agree to arrange collective representation. In the regulation of franchising the marginalization of a franchisee at every stage of the relationship means franchisee interests are not served. Regulation that seeks to curb opportunistic abuse of power in a market sector but that relies upon and consults only with those who engage in opportunistic practices and not those who experience them is inconsistent with the new learning on regulation, and it cannot be expected to be effective regulation.

Imbalance of power and problems of uncertainty for a franchisee are not adequately addressed by regulation. In fact regulation in its current form compounds the risks for franchisees, first because it reinforces the imbalance in stakeholder representation in the lack of balanced representation in the regulatory process and second, because it gives a false sense of protection that impairs a franchisee's meagre self-protective capacities in the face of consolidated franchisor power.

The failure of both private, self-regulatory measures and public, statutory intervention suggests a need for reframing regulatory process. In order to promote 'process, organization and distribution of rights and competencies', regulation should enable self-referential capacities of institutions 'to shape their own responses to complex social problems.'⁷⁶⁰ Regulation of franchising has enlisted the self-referential capacities of institutions, but the effectiveness of this approach is compromised by the nature of these institutions, primarily through their failure to establish a role for franchisees. 'The success of self-regulation depends on the key stakeholders in a market agreeing, preferably on a fully-inclusive basis, to cooperate in such an approach.'⁷⁶¹ The formulation of appropriate regulation is properly the product of a collaborative process that fully includes all stakeholders, in concert with the regulator. The regulation of the franchise sector is not optimally effective, largely because it fails to involve key stakeholders on a fully-inclusive basis.

Regulation of franchising can and should conform to current conceptions of best practice. To do this it must ensure a vital component of regulatory process that is

⁷⁶⁰ Sanford E. Gaines and Cliona Kimber, 'Redirecting Self-Regulation' (2001) 13 *Journal of Environmental Law* 157, referring to American theorist Eric Orts.

⁷⁶¹ Olga Borissova (ed), *Implementation of Regulatory Impact Assessment, Best Practices in Europe*, American University in Bulgaria, Sofia (2004) 36.

now lacking, reliable and accurate information. Information is crucial about franchising generally, the nature of the relationship, the nature of the roles played by the participants. The diversity of roles in the franchisor/franchisee relationship that attribute to a franchisee various qualities of employee, investor, consumer, and partner among others, cannot continue to be denied as well as negated by a contract provision that says franchisees are none of these things. It is necessary to recognize how and where these dimensions of the relationship should inform interpretation and regulation. Information and education is also crucial about the nature of the contract and the contract terms, as is accurate, reliable information about reputation of franchisors and other aspects of particular franchise systems. Regulation of franchising must ensure the effectiveness of disclosure through monitoring and enforcement, including registration. If the administrative burden is too great for the ACCC, then, as Rubin suggests, the monitoring of franchisors may require collective action by franchisees. The importance of franchising and its many benefits should not deter participants and observers from making a thorough and candid assessment of its costs as well as its benefits. In fact it is precisely because the sector is important that the full story should be told. An assessment of franchising with its warts as well as its many positive attributes will allow for a fuller understanding of the sector. Without such understanding, appropriate regulation to improve its competitiveness cannot be implemented.

Other important elements in regulatory process include using this improved information to identify problems collaboratively and selecting appropriate tools. There is no reason why the same reforms to regulation that relies heavily on trade association participation in the UK might not be implemented in Australia. Commentators have suggested alternative measures that might be successful in the regulation of franchising, such as content control, unfair terms legislation, and markets for fair dispute resolution, as proposed by Collins; good faith as proposed by Hadfield; and collective understanding of terms discussed by Black and Wightman. It does not matter so much what the regulation is or what tools and strategies are selected, because conditions in the sector and capabilities of regulatory process will change. What matters most is process that is fully-inclusive, participative and democratic. Currently, a franchisee is not a full participant in the regulation of the franchise relationship, but rather is subject to uncertainty and lacks power in each

layer of governance, market, contract and direct intervention. Franchisees remain marginalized, ‘infantilized’. Power is always relative; if franchisees are infantilized, then franchisors’ power is virtually absolute.

Given the imbalance of power and the uncertainty that prevail throughout the franchise relationship for franchisees, what started as the ‘promise’ of franchising for too many participants quickly becomes a nightmare. As Sciarra noted, the protection of franchisees is debatable. But the question should not be whether franchisees are protected, but rather whether they are equipped to protect themselves. The self-regulatory emphasis in franchising regulation puts the onus on franchisees, seeming not to recognize that they are incapable of playing their roles throughout the layers of governance of the relationship.

Ideally, a successful solution to the problems in franchising will come through collaborative process that includes franchisees and so recognizes and addresses the genuine needs and concerns of all the participants in the franchise relationship. Only franchisees can accurately describe what they need, and whether regulation is meeting its objectives in protecting their interests. This dissertation argues that franchise regulation in Australia should stimulate and encourage consultation, responsiveness and transparency and that it must implement improved cooperation and a realignment of roles in order to better address its objectives.⁷⁶² In reality, however, unity is power, and franchisees lack unity because they cannot freely communicate or secure collective representation. To help franchisees become better organized and represented, there is a need for a greater role to be played by the regulator. Franchisors have been quite happy to divide and conquer; this includes dividing the regulator from franchisees. Therefore the regulator cannot rely on the industry association and self-regulatory mechanisms; it must take the lead. The first step of that leadership role is to reframe the regulatory process with better measurement, better identification of problems and tools, and, above all, collaborative process.

This dissertation has been largely about the risks to franchisees from opportunism of franchisors that is left unchecked by regulation. It highlights the power of franchisors

⁷⁶² For example, Regulatory Reform lists tools or principals of public consultation as informality, circulation of regulatory proposals for public notice and comment, hearings, and advisory bodies (Australia has done most of these and more, because have done monitor and review of legislation, complete with submissions and surveys) See *Regulatory Reform* (2006) Jacobs & Associates <<http://www.regulatoryreform.com>> at 24 November 2006.

in the franchise relationship and the potential for the abuse of that power by opportunistic franchisors. The law has always recognized power, and has always required certain duties commensurate with power. In franchising the power enjoyed by a franchisor has been balanced by few legally-imposed duties towards franchisees. Business format franchising has evolved for over sixty years. The sector has matured, and Ray Kroc's franchising is an era that has passed. What is needed today in order to minimize opportunistic behaviour, to improve relationships within the sector, and to improve the health of the sector as a whole, is to align franchisors' and franchisee' interests as much as possible.⁷⁶³ While today's franchisor does need uniformity to protect the brand, system uniformity need not equate to a silencing of franchisees. It used to be that franchisors could and did prohibit franchisees from communicating with one another. Now the Code prohibits this, but franchisors still have ways of silencing franchisees, isolating them and depriving them of information. Franchisors consolidate their power, but are still able to avoid the concomitant responsibilities.

The good news is that most franchisors are not opportunistic. Good, quality franchisors sell a right to franchisees that is worth the price; franchisees in well-run systems can themselves enjoy handsome profits. It is these well-run franchise systems that will benefit most from reframed regulatory process and renewed measures to prevent abusive practices that not only harm individual franchisees but also damage the image of the sector as a whole. Franchisees and franchisors are part of the same system. Empowering franchisees and increasing their participation at all layers of governance ultimately will help to unify the sector and its image. Good franchisors actively seek out strong franchisees, because strong franchisees make for more profitable franchise systems for all participants and a healthier industry sector.

⁷⁶³ Address to the FCA Plenary Session, October 2006 by Rod Wakefield, CEO of The Coffee Club.

APPENDIX A

COMPARISON OF FORMER CODE OF PRACTICE TO CURRENT FRANCHISING CODE OF CONDUCT

	Franchising Code of Practice, 1 January, 1995, 3rd edition. (Voluntary code)	Franchising Code of Conduct (effective 1 October 1998) (current, mandatory Code)
Timing of Disclosure	<p>Franchisor must give you a Disclosure Document <i>at least seven days prior to signing a Franchise Agreement</i>, 9.2. You must before execution of any Franchise Agreement have received and read them (Item 10.1).</p> <p>A Disclosure Document is also required on renewal of a Franchise Agreement, Item 9.2.</p>	<p>A franchisor must give you a copy of the code and the disclosure document, in either electronic or hardcopy form, <i>at least 14 days before you enter into the agreement or pay the non-refundable money</i>, or at least 14 days before renewal or extension of the franchise</p>
<p>Disclosure: Re Territory (Item 8 Disclosure)</p> <p>See also Item 11 Disclosure</p>	<p>Franchisor must disclose particulars of any restrictions, eg. territorial...imposed on you. (Attachment A “Disclosure Document Requirements”, (vi)(d)).</p>	<p>8 whether the franchise is for an exclusive or non-exclusive territory or limited to a particular site; whether the franchisor or its associates may operate a business that is substantially the same as the franchise in the franchised territory; whether the franchisor or its associates may establish other franchises that are substantially the same as the franchise in the franchised territory; whether you may operate a business that is substantially the same as your franchise outside the franchised territory; and whether the <i>franchisor may change the territory</i>.</p> <p>11 Sites or Territories</p> <p>11.1 The policy of the franchisor, or an associate of the franchisor, for selection of as many of the following as are relevant: (a) the site to be occupied by the franchised business; (b) the territory in which the franchised business is to operate.</p> <p>11.2 Details of whether the territory or site to be franchised has been subject to a franchised business operated by a previous franchise granted by the franchisor and, if so, details of the franchised business, including the circumstances in which the previous franchisee ceased to operate.</p> <p>11.3 The details mentioned in item 11.2 may be in a separate document and may be made available for inspection at a time and place mentioned in the disclosure document.</p>
Disclosure: Re Other Issues	<p>Name, registered office, qualifications and business experience of Franchisor. (Attachment A “Disclosure Document</p>	<p>details of the franchisor, including the business experience of the people running the franchise (Items 2 and 3);</p>

	Requirements”, (i), (ii), (iii)).	
Disclosure: Re Other Issues	Details of debt, criminal or civil proceedings or bankruptcies/insolvency of Franchisor, Attachment A “Disclosure Document Requirements”, (v). Details of any current unresolved litigation with any existing or former Franchisees. (Attachment A “Disclosure Document Requirements”, (ix)).	details of criminal, trade practices and other litigation in circumstances listed (Item 4);
Disclosure: Re Other Issues		payments made to agents who recruit you (Item 5);
Disclosure: Re Other Issues	Details of number of Franchises terminated or not renewed, over the past year. (Attachment A “Disclosure Document Requirements”, (ix)).	details of existing franchises and those terminated — not renewed, transferred or bought back — by the franchisor, in the last three years (Item 6);
Disclosure: Re Other Issues	Examples of trademarks, logo, symbol etc and protection measures. (Attachment A “Disclosure Document Requirements”, (vi)(b)).	details of any trade mark, patent, design or copyright significant to the franchise system (Item 7);
Disclosure: Re Other Issues	Summary of terms and conditions for purchase of goods and services and situation if source fails, including rebate comment. (Attachment A “Disclosure Document Requirements”, (vi)(e)).	details of goods and services you acquire or provide, including restrictions and obligations on where you buy (Items 9 and 10);
Disclosure: Re Other Issues	Basis of Franchisor’s involvement/approval for site selection,. (Attachment A “Disclosure Document Requirements”, (vi)(f)).	the franchisor’s policy on site selection and details on the history of the site (Item 11);
Disclosure: Re Other Issues		details on marketing and cooperative funds (Item 12);
Disclosure: Re Other Issues	Clear and in writing prepayment requirements (and refund of) before sign the franchise (Item 11.1). Details of payments to be made and refund entitlement if terminate during ‘cooling off’ period. (Attachment A “Disclosure Document Requirements”, (vi)(c)).	details of money you are required to pay before you sign the franchise and when you are entitled to a refund (Item 13);
Disclosure: Re Other Issues	List of establishment costs. (Attachment A “Disclosure Document Requirements”, (vii)).	details of establishment costs and other payments (Item 13);
Disclosure: Re Other Issues	Details of financial requirements, eg. non borrowed capital. (Attachment A “Disclosure Document Requirements”, (viii)).	details of the financing arrangements (Item 14);
Disclosure: Re Other Issues	Summary of main obligations of Franchisor. (Attachment A “Disclosure Document Requirements”, (vi)(h)).	summary of conditions of agreement that deal with both your obligations and those of the franchisor (Items 15 and 16);
Disclosure: Re Other Issues	Summary of termination, renewal, goodwill and assignment. (Attachment A “Disclosure Document Requirements”, (vi)(g)).	summary of conditions of the agreement including such things as the term of the agreement, variations, renewal and extension, termination, goodwill (if

		any), transfer, mediation, franchisor’s right to inspect records and any restriction on your operations during and after the agreement (Item 17);
Disclosure: Re Other Issues		Obligation to sign related agreements including leases, hire purchase, security, confidentiality, restrictions on business (Item 18);
Disclosure: Re Other Issues	Franchisor’s viability statement, but not required if wholly owned subsidiary of public co. (Attachment A “Disclosure Document Requirements”, (iv) and Appendix 1).	a statement about the franchisor’s liquidity situation (Item 20); and
Disclosure: Re Other Issues	You must certify you have received and read the Disclosure Document. (Item 18)	provision for acknowledging your receipt of the disclosure document (Item 23).
Disclosure: Re Other Issues		The franchisor may attach a copy of the franchise agreement to the disclosure document. If the agreement itself discloses matters listed in Items 15, 16 and 17 above, then the disclosure document need only refer to their inclusion in the agreement.
Short-form disclosure		A franchisor proposing to enter, renew or extend a franchise with an annual turnover of less than \$50 000 may choose to provide short-form disclosure . This requires the inclusion of only 11 classes of information (annexure 2). Franchisee may still request full disclosure under the requirements in annexure 1.
Reas opp’ty to understand the code and the disclosure document, indep’t advice before entering the agreement ⁷⁶⁴	Franchisee must: (1) certify he had received and read: Disclosure Document, at least 7 days before signing the Franchise Agreement, FCC Guide, FCC Code of Practice, (Item 10.1); (2) provide a certificate from a legal advisor certifying explanation of the agreement or a statement that the agreement has been explained by a legal advisor, (Item 10.2).	Franchisee must provide a written statement - have received, read and had a reasonable opportunity to understand the code and the disclosure document. signed statement - have been given advice by an independent legal adviser, business adviser or accountant, or have been told to seek that kind of advice but chose not to.
Cooling off ⁷⁶⁵	Franchisee right to terminate within seven days from date of Franchise Agreement or any ‘agreement to agree’. Franchisee entitled to a refund of initial fees less reasonable expenses, (Item 11.2).	Franchisee right to terminate the agreement within seven days of entering into the agreement; or (b) making any payment whichever is earliest ...franchisee entitled to a refund, less the franchisor’s reasonable expenses if expenses or their method of calculation have been set out in the agreement. , within 14 days.

⁷⁶⁴ does not apply to the renewal or extension of a franchise agreement with a franchisor;

⁷⁶⁵ does not apply to the renewal or extension of a franchise agreement with a franchisor;

Franchisee Association		A franchisor cannot stop franchisees from forming an association or otherwise getting together
Disclosure: Lease (If franchisee leases from franchisor or its associate)		<p>Within one month after signing the lease, or agreement to lease, franchisor must provide</p> <ul style="list-style-type: none"> <input type="checkbox"/> a copy of its lease or agreement to lease; or <input type="checkbox"/> written details of conditions of occupation; or <input type="checkbox"/> the documents giving you the right to occupy the premises.
<p>Disclosure: Marketing and other cooperative funds (DISCLOSURE)</p> <p>See also item 12 disclosure</p>		<p>Where agreement reqs franchisee to provide money to any cooperative fund, the franchisor must:</p> <ul style="list-style-type: none"> <input type="checkbox"/> each financial year, from the start of the code, prepare a financial statement of the fund's receipts and expenses and the amount spent on production, advertising and administration; <input type="checkbox"/> have the statement audited within three months of the end of the financial year, unless 75 percent of franchisees agree otherwise; and <input type="checkbox"/> give franchisee a copy of the statement within 30 days of your request. <p>12 Marketing or other cooperative funds</p> <p>12.1 For each marketing or other cooperative fund, controlled or administered by or for the franchisor, to which the franchisee may be required to contribute, the following details:</p> <p>(a) the kinds of persons who contribute to the fund (for example, franchisee, franchisor, outside supplier);</p> <p>(b) whether the franchisor must contribute to the fund in relation to businesses owned or operated by the franchisor that are substantially the same as the franchised business and, if so, whether the contribution is worked out in the same way as for a franchisee;</p> <p>(c) how much the franchisee must contribute to the fund & whether other franchisees must contribute at a different rate;</p> <p>(d) who controls or administers the fund;</p> <p>(e) whether the fund is audited and, if so, by whom and when;</p> <p>(f) whether the fund's financial statements can be inspected by, or will be given to, franchisees;</p> <p>(g) the kinds of expense for which the fund may be used;</p> <p>(h) the fund's expenses for the last financial year, including the percentage spent on production, advertising, administration and other stated expenses;</p> <p>(i) whether the franchisor or its associates supply goods or services for which the fund pays and, if so, details of the</p>

		<p>goods or services;</p> <p>(j) whether the franchisor must spend part of the fund on marketing, advertising or promoting the franchisee's business.</p>
26. Transfer		<p>Franchisee request for franchisor's consent to transfer must be in writing.</p> <p>Franchisor cannot unreasonably withhold consent.</p> <p>See Item 20(3): circumstances in which it is reasonable for a franchisor to withhold consent:</p> <p>(a) the proposed transferee is unlikely to be able to meet the financial obligations that the proposed transferee would have under the franchise agreement; or</p> <p>(b) the proposed transferee does not meet a reasonable requirement of the franchise agreement for the transfer of a franchise; or</p> <p>(c) the proposed transferee has not met the selection criteria of the franchisor; or</p> <p>(d) agreement to the transfer will have a significantly adverse effect on the franchise system; or</p> <p>(f) the proposed transferee does not agree in writing to comply with the obligations of the franchisee under the franchise agreement; or</p> <p>(g) the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor; or</p> <p>(h) the franchisee has breached the franchise agreement and has not remedied the breach.</p> <p>If franchisor does not respond in writing that consent is withheld and giving reasons for withholding — within 42 days — consent is taken to have been given</p>
Disclosure: Franchisor rt of 1st refusal		Must be disclosed [Disclosure 17.1(l)]
Disclosure: IP, Confid'l information		Disclosure
Disclosure: Supply of Products by Franchisor	Summary of terms and conditions for purchase of services, goods, fixtures and property from Franchisor or other if supply by Franchisor fails, (Attachment A, (vi)(e)).	<p><u>In Disclosure:</u></p> <p>9 Supply of goods or services to a franchisee</p> <p>9.1 For the franchisor's requirements for supply of goods or services to a franchisee — details of:</p> <p>(a) any requirement for the franchisee to maintain a level of inventory or acquire an amount of goods or services; and</p> <p>(b) restrictions on acquisition of goods or services by the franchisee from other sources; and</p> <p>(c) ownership by the franchisor or an associate of the franchisor of an interest in any supplier from which the franchisee may be required to acquire goods or</p>

- services; and
- (d) the obligation of the franchisee to accept goods or services from the franchisor, or from an associate of the franchisor;
- and
- (e) the franchisor's obligation to supply goods or services to the franchisee; and
- (f) whether the franchisee will be offered the right to be supplied with the whole range of the goods or services of the franchise; and
- (g) conditions under which the franchisee can return goods, and to whom; and
- (h) conditions under which the franchisee can obtain a refund for services provided by the franchisor, and from whom;
- and
- (i) whether the franchisor may change the range of goods or services, and if so, to what extent; and
- (j) whether the franchisor, or an associate of the franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, and whether any rebate or financial benefit is shared, directly or indirectly, with franchisees.

Note Before a requirement is made under paragraph (b) or (c), the franchisor may notify, or seek authorisation from, the Australian Competition and Consumer Commission (see Act, Part VII).

In Summary materials:

Third line forcing [ss. 47(6) and 47(7)]:

Franchisor forces a franchisee to purchase goods or services from a third party, or provides a price incentive for someone to purchase goods or services from a third party.

Franchisors may impose quality standards on franchisees. Franchisors can also nominate suppliers who meet these standards. However, franchisors cannot prevent a franchisee from acquiring goods or services from a supplier of the franchisee's choice, if that supplier meets the franchisor's quality standards.

If a franchisor requires that specific equipment or software be used by a franchisee, even if this equipment supplier is at arm's length from the franchisor, it will constitute third line forcing.

(If any goods or services that the franchisee must acquire are subject to any registered patent, design, copyright or rights under the *Circuits Layout Act 1989*, they may be subject to supply restrictions contained in the licence agreement in relation to those rights. Under these circumstances, if the

		restriction genuinely relates to the intellectual property rights in goods or services, then prescribing a particular source may not be third line forcing.)
Disclosure: Supply of Products by Franchisee		<p>10 Supply of goods or services by a franchisee</p> <p>10.1 For the franchisor's requirements for supply of goods or services by a franchisee — details of:</p> <p>(a) restrictions on the goods or services that the franchisee may supply; and</p> <p>(b) restrictions on the persons to whom the franchisee may supply goods or services; and</p> <p>(c) whether the franchisee must supply the whole range of the goods or services of the franchise.</p> <p><i>Note</i> Before a requirement is made under paragraph (a) or (b), the franchisor may notify, or seek authorisation from, the Australian Competition and Consumer Commission (see Act, Part VII).</p>
Pricing		Not in Code, but in explanatory summary: When competitors reach an agreement to fix, maintain, or control the prices that they charge for goods and services. The agreement does not have to be in writing.
Disclosure re pmts		<p>13 Payments</p> <p><i>Prepayments</i></p> <p>13.1 If the franchisor requires a payment before the franchise agreement is entered into — why the money is required, how the money is to be applied and who will hold the money.</p> <p>13.2 The conditions under which a payment will be refunded.</p> <p><i>Establishment costs</i></p> <p>13.3 Details of the range of costs to start operating the franchised business, based on current practice, for the following matters:</p> <p>(a) real property, including property type, location and building size;</p> <p>(b) equipment, fixtures, other fixed assets, construction, remodelling, leasehold improvements and decorating costs;</p> <p>(c) inventory required to begin operation;</p> <p>(d) security deposits, utility deposits, business licences, insurance and other prepaid expenses;</p> <p>(e) additional funds, including working capital, required by the franchisee before operations begin;</p> <p>(f) other payments by a franchisee to begin operations.</p> <p>13.4 For item 13.3, the details for each payment must include:</p> <p>(a) description of the payment; and</p> <p>(b) amount of the payment or the formula used to work out the payment; and</p> <p>(c) to whom the payment is made; and</p> <p>(d) when the payment is due; and</p> <p>(e) whether the payment is refundable and, if so,</p>

		<p>under what conditions.</p> <p>13.5 For item 13.4, if the amount of the payment cannot easily be worked out — the upper and lower limits of the amount.</p> <p><i>Other payments</i></p> <p>13.6 For each recurring or isolated payment payable by the franchisee to the franchisor or an associate of the franchisor or to be collected by the franchisor or an associate of the franchisor for another person:</p> <ul style="list-style-type: none"> (a) description of the payment; and (b) amount of the payment or formula used to work out the payment; and (c) to whom the payment is made; and (d) when the payment is due; and (e) whether the payment is refundable and, if so, under what conditions. <p>13.7 For item 13.6, if the amount of the payment cannot easily be worked out, the upper and lower limits of the amount.</p>
<p>Disclosure: Franchisor’s oblig’ns</p>	<p>Summary of the main obligations of Franchisor (including initial and ongoing training to be provided), (Attachment A, (vi)(h)).</p>	<p>15 Franchisor’s obligations</p> <p>15.1 Summary of the conditions of the franchise agreement that deal with obligations of the franchisor (or references to the relevant conditions of the franchise agreement, if attached), including:</p> <ul style="list-style-type: none"> (a) an obligation to provide training: <ul style="list-style-type: none"> (i) before the franchised business starts; and (ii) during operation of the franchised business; and (b) any obligation that continues after the franchised business ceases to operate.
<p>Disclosure: Franchisee operational oblig’ns</p>		<p>16 Franchisee’s obligations</p> <p>16.1 Summary of the conditions for the following matters:</p> <ul style="list-style-type: none"> (a) site selection and acquisition; (b) requirements for starting the franchised business; (c) development of the site, premises, vehicles and equipment; (d) training: <ul style="list-style-type: none"> (i) before the franchised business starts; and (ii) during operation of the franchised business; (e) opening the franchised business; (f) complying with standards or operating manuals; (h) warranties and customer service; (i) territorial development and minimum performance criteria; (j) maintenance and appearance of premises, vehicles and equipment; (k) insurance; (l) marketing; (m) indemnities and guarantees; (n) participation requirements for the franchisee or its directors, management or employees;

		(o) records and reports; (p) inspections and audit.
Disclosure: Ongoing Disclosure req'ts	<p>Details of any materially relevant debt, criminal or civil proceedings or bankruptcies/insolvency of Franchisor, Attachment A "Disclosure Document Requirements", (v).</p> <p>Details of any current unresolved litigation with any existing or former Franchisees. (Attachment A "Disclosure Document Requirements", (ix)).</p>	<p>18 Disclosure of materially relevant facts</p> <p>(1) If a disclosure document does not mention a matter mentioned in subclause (2), the franchisor must tell a franchisee or prospective franchisee about the matter, in writing, within a reasonable time (but not more than 60 days) after the franchisor becomes aware of it.</p> <p>(2) For subclause (1), the matters are:</p> <p>(a) change in majority ownership or control of the franchisor;</p> <p>(b) proceedings by a public agency, a judgment in criminal or civil proceedings or an award in an arbitration against the franchisor in Australia alleging:</p> <p>(i) breach of a franchise agreement; or</p> <p>(ii) contravention of trade practices law; or</p> <p>(iii) contravention of the Corporations Law; or</p> <p>(iv) unconscionable conduct; or</p> <p>(v) misconduct; or</p> <p>(vi) an offence of dishonesty;</p> <p>(c) a judgment against the franchisor, other than for unfair dismissal of an employee, under:</p> <p>(i) section 127A or 127B of the <i>Workplace Relations Act 1996</i>; or</p> <p>(ii) section 106 of the <i>Industrial Relations Act 1996</i> of New South Wales; or</p> <p>(iii) section 276 of the <i>Industrial Relations Act 1999</i> of Queensland;</p> <p>(d) civil proceedings in Australia against the franchisor by at least 10%, or 10, of the franchisees in Australia of the franchisor (whichever is the lower);</p> <p>(e) any judgment that is entered against the franchisor in Australia, and is not discharged within 28 days, for at least:</p> <p>(i) for a small proprietary company — \$100,000; or</p> <p>(ii) for any other company — \$1,000,000;</p> <p>(f) any judgment that is entered against the franchisor in a matter mentioned in item 4.2 of Annexure 1 or item 3.2 of Annexure 2;</p> <p>(g) the franchisor becoming an externally-administered body corporate;</p> <p>(h) a change in the intellectual property, or ownership or control of the intellectual property, that is material to the franchise system.</p> <p>19 Current disclosure document</p> <p>(1) A franchisor must give to a franchisee a current disclosure document within 14 days after a written request by the franchisee.</p>

		(2) However, a request under subclause (1) can be made only once in 12 months.
Disclosure re Financing	Details of any financial requirements by Franchisor to Franchisee, (Attachment A, (viii)).	<p>Financing</p> <p>14.1 The material conditions of each financing arrangement that the franchisor, its agent or an associate of the franchisor offers to the franchisee for establishment or operation of the franchised business.</p> <p>14.2 For item 14.1, the material conditions of a financing arrangement include the following:</p> <p>(a) any requirement that the franchisee must provide a minimum amount of unborrowed working capital for the franchised business;</p> <p>(b) any requirement that a franchisee must meet a stated debt to equity ratio in relation to the franchised business.</p>
Terminat'n – Franchisee in Breach (21)		<p>Franchisor must give reasonable notice, telling you what needs to be done to fix the breach and allowing you reasonable time to fix it (max 30 days).</p> <p>If you fix the problem the franchisor cannot terminate the agreement for this breach.</p> <p>Franchisee can use the dispute resolution part of the code to resolve disputes arising from this action.</p>
Terminat'n – Franchisee not in Breach (22)		<p>Franchisor must give reasonable written notice and reasons.</p> <p>Franchisee can use the dispute resolution part of the code to resolve disputes arising from this action.</p> <p>This right of termination with reasonable notice does not affect any other contractual rights under the franchise agreement. (in summary but not in Code)</p> <p>A condition of agreement that a franchisor can terminate without the consent of the franchisee is not taken to be consent.</p>
Terminat'n without notice		Same as special circs (23) ?
Terminat'n Special circumstances (23)		<p>Franchisor does not have to comply with the termination requirements of 21 or 22 if franchisee:</p> <ul style="list-style-type: none"> <input type="checkbox"/> no longer hold a licence needed to carry on your business; <input type="checkbox"/> become bankrupt or insolvent; <input type="checkbox"/> abandon the franchised business; <input type="checkbox"/> are convicted of a serious offence; <input type="checkbox"/> operate the business so that it endangers public health or safety;

		<input type="checkbox"/> commit fraud in relation to the business; or <input type="checkbox"/> agree to terminate the franchise agreement.
Dispute Resolution	(Item 13).	See Part 4
Indemnity/Exclusion Clauses/Disclosures	Franchisor will not participate in unconscionable conduct (Item 12.1) and conduct unnecessary and unreasonable in relation to risks to be incurred by one party (Item 12.2(b)).	Agreement must not contain, or require a franchisee to sign, a general release of the franchisor from liability towards the franchisee.
Disclosure: Re other conditions	Summary of main particulars and features of franchise, (Attachment A, (vi)).	17 Summary of other conditions of agreement 17.1 Summary of the conditions that deal with the following matters: (a) term of the franchise agreement; (b) variation; (c) renewal or extension; (d) conditions the franchisee must meet to renew or extend the franchise agreement; (e) termination by the franchisor; (f) termination by the franchisee; (g) the franchisee's goodwill, if any, on termination or expiry; (h) the franchisee's obligations when a franchise agreement is terminated, expires or is not renewed; (i) the franchisor's rights to sell its business; (j) transfer of a franchise; (k) mediation; (l) option or right of first refusal, if any, for the franchisor to buy the franchised business; (m) the franchisor's rights, if any, to inspect financial and other records of the franchised business; (n) confidentiality of the franchisee's records; (o) death or disability of the franchisee or a director or shareholder of the franchisee; (p) details of the operation or establishment of any franchisee representative body, eg Franchise Advisory Council; (q) restrictions on the franchisee's operation of other businesses during or after the term of the franchise agreement; (r) operations manual; (s) choice of governing law.
Disclosure: re related agreement		18 Obligation to sign related agreements 18.1 Summary of any requirements under the franchise agreement for the franchisee or directors, shareholders, beneficiaries, owners or partners of the franchisee to enter into any of the following agreements: (a) a lease, sublease, licence or other agreement

		<p>under which the franchisee can occupy the premises of the franchised business;</p> <p>(b) a chattel lease or hire purchase agreement;</p> <p>(ba) an agreement under which the franchisee gains ownership of, or is authorised to use, any intellectual property;</p> <p>(c) a security agreement, including a guarantee, mortgage, security deposit, indemnity, loan agreement or obligation to provide a bank guarantee to a third party;</p> <p>(d) a confidentiality agreement;</p> <p>(e) an agreement not to carry on business within an area or for a time after the franchise agreement is terminated.</p>
<p>Disclosure Earnings info and financials</p>	<p>Franchisor’s viability statement, but not required if wholly owned subsidiary of public co. (Attachment A “Disclosure Document Requirements”, (iv) and Appendix 1). Projections, including basis and assumptions, (Attachment A “Disclosure Document Requirements”, (x)).</p>	<p>19.2 Earnings information may be given in a separate document attached to the disclosure document.</p> <p>19.3 Earnings information includes information from which historical or future financial details of a franchise can be assessed.</p> <p>19.4 If earnings information is not given — the following statement: The franchisor does not give earnings information about a <i>[insert type of franchise]</i> franchise. Earnings may vary between franchises. The franchisor cannot estimate earnings for a particular franchise.</p> <p>19.5 Earnings information that is a projection or forecast must include the following details:</p> <p>(a) the facts and assumptions on which the projection or forecast is based;</p> <p>(b) the extent of enquiries and research undertaken by the franchisor and any other compiler of the projection or forecast;</p> <p>(c) the period to which the projection or forecast relates;</p> <p>(d) an explanation of the choice of the period covered by the projection or forecast;</p> <p>(e) whether the projection or forecast includes depreciation, salary for the franchisee and the cost of servicing loans;</p> <p>(f) assumptions about interest and tax.</p> <p>20 Financial details</p> <p>20.1 A statement as at the end of the last financial year, signed by at least 1 director of the franchisor, whether in its directors’ opinion there are reasonable grounds to believe that the franchisor will be able to pay its debts as and when they fall due.</p> <p>20.2 Financial reports for each of the last 2 completed financial years that have been prepared by the franchisor in</p>

		accordance with sections 295 to 297 of the Corporations Law. 20.3 Item 20.2 does not apply if: (a) the statement under item 20.1 is supported by an independent audit provided by a registered company auditor within 12 months after the end of the financial year to which the statement relates; and (b) a copy of the independent audit is provided with the statement under item 20.1.
Comments/ Other provisions		Protect IP, protect franchisor's rights to do biz & sell other franchises Sunk costs, lease commitment reduce franchisee free-riding & walk-away ?????
Council membership	Representation: 5 Franchisees, 5 franchisors, 2 service providers/advisers, 1 lawyer, 1 chairperson and 1 government observer, (Item 1.2).	
Council membership term	Two years, up to four only.	
Council meeting frequency	Quarterly or more frequently.	
Role of Council	(Item 1.6) (a) revise FCC as required. (b) advise on franchise policy and complete tasks for the Minister for Small Business. (c) administer registration to FCC. (d) review and monitor FCC and make improvement recommendations. (e) report annually to Minister for Small Business (f) deregister persons who fail to comply with Code. (g) appoint franchise conciliator(s). (h) exempt inappropriate compliance to FCC where appropriate.	
Funding of Council	Initial establishment funding provided by Commonwealth. Full cost recovery of administration with 2 years of commencement. (Item 2.1)	
Compliance Registration Fee	Franchisors, Advisers and Service Providers to pay compliance upon registration and annually thereafter. (Item 2.2).	
Recovery of Registration Fees by Franchisors	Franchisors may recover portion of registration fee from franchisees as set by the Council. (Item 2.3)	
Franchise – Def'n	Item 3.1(a) "Franchise" is a contract that includes: Franchisee granted the right to use a mark recognised by the public to be associated with Franchisor; Franchisee conduct business in accordance	A definition of franchise agreement is provided in clause 4(1) and is critical to the operation of the Code. That definition provides that: "A franchise agreement is an agreement:

with Franchisor's marketing, business or technical plan or system.

Franchisor provide ongoing marketing, business or technical assistance.

Where the above obligations are not express then a contract will be deemed a franchise if it purports to be a franchise and includes any franchise covered by the Petroleum Retail Marketing Franchise Act 1980.

(a) that takes the form, in whole or part, of any of the following:

- (i) a written agreement;
- (ii) an oral agreement;
- (iii) an implied agreement; and
- (b) in which a person (the franchisor) grants to another person (the franchisee) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and

(c) under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol:

- (i) owned, used or licenced by the franchisor or an associate of the franchisor; or
- (ii) specified by the franchisor or an associate of the franchisor; and
- (d) under which, before starting business or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount including, for example:
 - (i) an initial capital investment fee; or
 - (ii) a payment for goods or services; or
 - (iii) a fee based on a percentage of gross or net income whether or not called a royalty or franchise service fee; or
 - (iv) a training fee or training school fee;but excluding:
 - (v) payment for goods or services at or below their wholesale price; or
 - (vi) repayment by the franchisee of a loan from the franchisor; or
 - (vii) payment for the wholesale price of goods taken on consignment; or
 - (viii) payment of market value for purchase or lease of real property, fixtures, equipment or supplies needed to start business or to continue business under the franchise agreement."

An agreement which satisfies this definition will be covered by the Code unless specifically excluded by another provision of the Code. A number of such exclusions are provided for in the Code.

Significantly, clause 4(2)(b) of the Code also provides for a specific inclusion dealing with motor vehicle dealer agreements. A motor vehicle dealership is been defined in clause 3 of the Code: "motor vehicle dealership means a business of buying, selling, exchanging or leasing motor

vehicles that is conducted by a person other than a person who is only involved as a credit provider, or provider of other financial services, in the purchase, sale, exchange or lease."

A definition of motor vehicle is also provided in clause 3.

EXCLUSIONS

The following are specific exclusions to the Code:

under clause 4(3) a number of specified legal relationships are not in themselves to be considered a franchise agreement. These relationships include:

an employer and employee relationship;

a partnership relationship;

a landlord and tenant relationship;

a mortgagor and mortgagee relationship;

a lender and borrower relationship;

the relationship between the members of a cooperative that is registered, incorporated or formed under a relevant Australian law.

the Code does not, in accordance with clause 5(3)(a), apply to non resident franchisor where the franchisor:

is not a resident, domiciled or incorporated in Australia; and

grants only one franchise or master franchise to be operated within Australia.

under clause 5(3)(b), the Code will not apply to a franchise agreement covered by another code which is prescribed as mandatory pursuant to the Australian Trade Practices Act.

subject to one important proviso,¹⁵ the Code does not, in accordance with clause 5(3)(c), apply to a franchise agreement that:

		<p>relates to goods or services that are substantially the same as those supplied by the franchisee for at least 2 years immediately before entering into the agreement; and</p> <p>the sales of goods or services under the proposed franchise will not provide more than 20% of the franchisee's gross turnover for goods or services of that kind during the first year of the franchise agreement.</p>
Non-Compliance to Code	<p>(Item 5.1) A registered party to the FCC will be removed if:</p> <p>(a) fails to renew registration or pay registration fees in time. (b) notifies no longer agrees FCC applies or ceased in business of franchising (c) removed by Council under Item 5.2.</p> <p>(Item 5.2) Council has power to remove a party if:</p> <p>(a), (b) not complying with Item 12 'Standards of Conduct' and fails to show cause why it should not be removed within 21 days. (c) where a subcommittee of the Council finds failure to show cause by party's response, unless an appeal is lodged within 21 days of receipt of such notice. (d) where full Committee of the Council finds failure to show cause then within 7 days of notice.</p>	
Publicity – Register of Compliance	<p>(Item 7.3) Register of compliance will be made available as a public document.</p>	
Standards of Conduct of Franchisor and Franchisee (Unconscionable Conduct)	<p>(Item 12) - Franchisors and Franchisees will not participate in 'unconscionable conduct' (Item 12.1) - Franchisors and Franchisees will act 'in an ethical, honest and lawful manner' and pursuing best franchise practice (Item 12.2). - In dealings with each other Franchisors and Franchisees should at least avoid the following conduct, when such conduct would cause significant detriment to either party's business: (a) substantial and unreasonable overvaluation</p>	<p>The Code was written with an awareness of the new section 51AC in the TPA... (se RIS?) The mandatory Code no longer includes the provisions that were contained in the voluntary Code of Practice regarding fair conduct, etc⁷⁶⁶ Section 51AC requires a court to consider of the provisions of any relevant industry codes in determining whether a conduct has been unconscionable.⁷⁶⁷</p>

⁷⁶⁶ The voluntary code provision:

While s51AC...

See also Terry, Franchising Regulation in Asia

⁷⁶⁷ Source: <<http://www.selfregulation.gov.au/publications/PrescribedCodesOfConduct/background.asp>

	<p>of fees and prices;</p> <p>(b) conduct which is unnecessary and unreasonable in relation to risk;</p> <p>(c) conduct that is ‘not reasonably necessary’ for the protection of the legitimate business interests of Franchisor, Franchisee or Franchise system.</p>	
Service Providers compliance to Code	<p>- Banks and Financial Institutions that register under the Code agree to comply with the Code by providing customised finance packages to registered Franchisors (Item 16.1).</p> <p>- Publishers and media that register under the Code agree to comply with the Code by ensuring that:</p> <p>(a) franchise advertisements comply with the requirements of the code, and</p> <p>(b) franchise opportunity advertisements are placed within a distinct classification section for registered Franchisors.</p>	

Summary of differences:

New code has increased disclosure obligations, e.g. advertising funds, supply, payments, intellectual property
Termination and transfer requirements
Franchisee association
general release from liability
Enforcement

Differences: provisions in new Code, not in old code

payments made to agents who recruit you (Item 5);
details on marketing and cooperative funds (Item 12);

Obligation to sign related agreements including leases, hire purchase, security, confidentiality, restrictions on business (Item 18);

A franchisor cannot stop franchisees from forming an association or otherwise getting together

Within one month after signing the lease, or agreement to lease, franchisor must provide

- a copy of its lease or agreement to lease; or
- written details of conditions of occupation; or
- the documents giving you the right to occupy the premises.

Where agreement reqs franchisee to provide money to any cooperative fund, the franchisor must:

- each financial year, from the start of the code, prepare a financial statement of the fund’s receipts and expenses and the amount spent on production, advertising and administration;
- have the statement audited within three months of the end of the financial year, unless 75 percent of franchisees agree otherwise; and
- give franchisee a copy of the statement within 30 days of your request.

12 Marketing or other cooperative funds

- 10 Supply of goods or services by a franchisee**
- 13 Payments**
- 16 Franchisee's obligations**
- 17 Summary of other conditions of agreement**
- 18 Obligation to sign related agreements**

In old code, not in new:

Council membership

Representation: 5 Franchisees, 5 franchisors, 2 service providers/advisers, 1 lawyer, 1 chairperson and 1 government observer, (Item 1.2).

Council meeting frequency

Role of Council

Funding of Council

Compliance Registration Fee

Recovery of Registration Fees by Franchisors

Non-Compliance to Code

Publicity – Register of Compliance

Service Providers compliance to Code

APPENDIX B

CONTRACT TERM: TRANSFER

F1

Franchisee understand and acknowledges that the rights and duties set forth in this Agreement are personal to Franchisee and/or to any person(s) who holds a direct or indirect controlling interest in Franchises (whether as controlling shareholder or as a general partner), and that Sub-Franchisor has granted the Franchisee in reliance on the business skill and experience, financial capacity and personal character of Franchisee and/or any such person(s). Accordingly, neither Franchisee nor any immediate or remote successor to any part of Franchisee's interest in the Franchise, nor any individual, partnership, corporation or other legal entity which directly or indirectly owns any interest in the Franchisee or in Franchisee shall sell, assign, transfer, convey, give away, pledge, mortgage, or otherwise encumber any direct or indirect interest in the Franchisee or the Franchisee (including, without limitation, shares of corporation stock of or general partnership interests in Franchisee, which constitutes direct or indirect ownership or control of Franchisee) without the prior written consent of Sub-Franchisor. Any such purported assignment or transfer of an interest in the Franchise by operation of law or otherwise, not having the written consent of Sub-Franchisor required by this Section 18 shall be null and void and shall constitute a material breach of this Agreement. Any such purported assignment or transfer of any interest in the Franchisee shall also constitute a material breach of this Agreement. F1 or Sub-Franchisor may in any such event then terminate without opportunity to cure pursuant to Section 16.3. Sub-Franchisor may withhold its consent for any of the reasons contemplated as being valid by the Franchising Code of Conduct as amended from time to time.

18.2 Except in the case of a transfer of the Franchisee to a corporation formed for the convenience of ownership or in the case of a transfer by devise or inheritance, upon a permitted transfer of the Franchise, Franchisee shall pay to Sub-Franchisor a transfer fee of Five Thousand Dollars (\$5,000).

18.3 The foregoing provisions of Section 18.1 to the contrary notwithstanding, Franchisee may grant a security interest in the Store or in any of its assets in connection with a bona fide financing or refinancing of the Store relating to the acquisition, renovation, repair, replacement or operation of the Store or the Premises provided that the secured party agrees that in the event of any default by Franchisee under any documents related to the security interest. Sub-Franchisor shall have the right and option to purchase the indebtedness secured by such security interest at a price equal to the then unpaid balance of such indebtedness.

18.4 No person or entity shall succeed to any of the rights of Franchisee under this Agreement by virtue of any voluntary or involuntary proceeding in bankruptcy, receivership, attachment, execution, assignment for the benefit of creditors or other legal process.

18.5 The Franchisee acknowledges that the rights granted to it herein by the Sub-Franchisor are granted in pursuance of an express authority to do so by F1 and that such authority does not permit the Franchisee to appoint any Sub-Sub-Franchisee. Accordingly, the Franchisee shall not appoint nor shall it commit itself to appoint any Sub-sub-franchisee.

F2

The rights and obligations of the Franchisee under this Agreement are personal to the Franchisee. Neither the Franchisee nor the Shareholders are entitled to:

- (a) sell, assign, transfer or encumber in whole or in part its legal or beneficial entitlement or interest:
 - (i) in this Agreement; or
 - (ii) in the Franchisee;
- (b) sub contract or delegate the performance of any of its rights, duties or obligations under this Agreement except as provided for in this Agreement,
 - to any person without the prior written consent of the Franchisor.

20.4 Conditions of consent.

The Franchisor must not unreasonably withhold its consent to an assignment under clause 20.3. The Franchisor's consent to a sale, assignment or transfer to a proposed transferee may be withheld absolutely or granted upon such conditions as the Franchisor in its discretion considers reasonably appropriate. The Franchisor will provide its consent if:

- (a) the Franchisee is not in default or arrears in respect of any payments owing to the Franchisor;
- (b) the proposed transferee is in the opinion of the Franchisor a respectable, responsible, solvent and financially sound person with sufficient business experience to carry on the Business and to fully and expeditiously carry out the Franchisee's obligations under this Agreement;
- (c) the Franchisee pays to the Franchisor its full costs of the investigation of the proposed transferee its directors, officers, employees and shareholders and any person who proposes to give any guarantee, indemnity or other security in respect of the proposed transferee, together with the Assignment Fee (if any);
- (d) the proposed transferee signs:
 - (i) an acknowledgement of receipt of the Franchisee's Disclosure Document;
 - (ii) a new franchise agreement in the form of the Franchisor's then current franchise agreement;
 - (iii) such agreement or agreements as are reasonably required by the Franchisor (to be prepared by the Franchisor's solicitors at the Franchisee's expense) under which the proposed transferee agrees to be bound and perform the Franchisee's obligations under this Agreement as if it were originally named in this Agreement; and
 - (iv) each other document as may customarily be required by the Franchisor of other franchisees;
- (e) the proposed transferee obtains all guarantees, indemnities, covenants of restraint and/or other documents or securities as the Franchisor may reasonably require for the fulfilment of the proposed transferee's obligations under this Agreement;
- (f) the proposed transferee agrees at its cost to undergo or causes its Nominated Operator or employees to undergo any training programme prescribed from time to time by the Franchisor and pays to the Franchisor the full cost of doing so which cost is included in the Assignment Fee;
- (g) the Franchisee agrees to execute a general release of the Franchisor's Authorised Representatives from all Claims that it may have against the Franchisor's Authorised Representatives in respect of this Agreement, or the Business and agrees to remain liable for its pre-existing obligations under this Agreement;
- (h) the proposed transferee acquires all of the Franchisee's essential assets used in the Business and assumes all of the Franchisee's obligations in relation to it;
 - (i) the Franchisee has given the Franchisor REASONABLE Notice of the proposed transfer to enable it to comply with its obligations under the Code;
 - (j) the Franchisee has given to:
 - (i) the prospective transferee; and
 - (ii) the Franchisor, a copy of the Franchisee's Disclosure Document and the proposed transferee acknowledges receipt of it before the proposed transferee agrees to purchase the Business or the Franchise or any interest in the Franchisee; and
 - (k) the proposed transferee agrees to take over occupation of the Premises in accordance with the Term of the Premises Agreement either by assignment of the lease, sublease or licence or the

grant of a new lease, sublease or licence to meet the then current requirements of the Franchisor and the Franchisee.

F3

S.35 Assignment

S.35.1 Assignment by Franchisor

The Franchisor may assign this agreement or any right arising out of this agreement to any company or other legal entity that agrees to assume all of the Franchisor's obligations under this agreement by giving 14 days notice to the Franchisee.

S.35.2 Assignment by Franchisee

The Franchisee must not assign or attempt to assign this agreement or any right arising out of this agreement unless:

- (a) it complies with clause
- (b) the Franchisee is not in breach of this agreement;
- (c) the Franchisee pays the Franchisor's an assignment fee of 10% of the proposed purchase price or such other fee as the Franchisor may publish from time to time;
- (d) the Franchisee ensures that the assignee assumes all of the Franchisee's obligations under this agreement;
- (e) the Franchisee pays all amounts owed to the Franchisor on or before the date of assignment;
- (f) in the Franchisor's opinion the assignee is of good character and possesses the business experience and capability, credit standing, health, licences and financial resources necessary to operate the F3 Business successfully and meets the criteria of the Franchisor for the selection of new Franchisees;
- (g) the assignee has satisfactorily completed any training required by the Franchisor;
- (h) the assignee as Franchisee and each shareholder of the assignee as principal executes the Franchisor's then current franchise agreement (which has a term equal to the remaining part of the Term or any Renewal and which differs from this agreement as to material and non-material terms and conditions);
- (i) the Franchisee provides all assistance requested by the Franchisor to enable the Franchisor to apply to cancel the registration of any registered user agreement between the Franchisor and the Franchisee relating to any Trade Mark;
- (j) the Franchisee and each Principal comply with such other conditions as the Franchisor, acting reasonably, may impose; and
- (k) the Franchisee has paid to the Franchisor the Franchisor's costs in relation to the assignment, including but not limited to the Franchisor's then current published assignment costs and its costs of providing training to the assignee and legal and other costs incurred by the Franchisor in approving the assignment and the documents affecting the assignment.

S.35.3 Change to board or voting rights of Franchisee

Any transaction or series of transactions which results in a change of the composition of the board of the Franchisee, or the legal or beneficial ownership of or the power to exercise the voting rights of more than 24 percentum of the issued capital of the Franchisee if attempted shall be deemed to be an assignment of this agreement.

S.35.4 Franchisee not to encumber

The Franchisee must not encumber the Licence or any of the Franchisee's assets used in the F3 Business without the Franchisor's approval.

24. Right of first refusal (Franchise)

24.1 Franchisor to have right of first refusal

If at any time:

- (a) the Franchisee wishes to assign the Licence to a third party; or
 - (b) a Principal wishes to transfer to a third party any shares in the Franchisee ('Shares')
- then, before entering into any agreement with the third party, the assignor must:
- (c) notify the Franchisor of the terms, including the price, of the proposed transaction (a 'Sale Proposal');
 - (d) provide the Franchisor with all other information reasonably requested by the Franchisor to evaluate the Sale Proposal; and
 - (e) provide the Franchisor with the Franchisor's then current Franchise application completed by the proposed assignee.

24.2 Franchisor to give notice

If within 30 days after receipt of the Sale Proposal and other information referred to in clause 0:

- (a) the Franchisor gives notice to the assignor that it wishes:
 - (i) to operate the F3Business at the Location under the Approved Name, the parties will terminate this agreement and the Franchisor must pay the Franchisee in accordance with the Sale Proposal; or
 - (ii) to acquire the Shares, the assignor must transfer the Shares to the Franchisor on the terms set out in the Sale Proposal; or
- (b) the Franchisor gives notice to the assignor that it does not wish to operate the F3Business or acquire the Shares or does not give any notice to the assignor, the assignor may assign the Franchise or the Shares to the person named in the Sale Proposal on terms no more favourable than those contained in the Sale Proposal and subject to satisfaction of the provisions of clause.

24.3 Franchisor to purchase

If the Sale Proposal includes:

- (a) in the price payable by the purchaser consideration other than money, the price payable by the Franchisor for the Franchise or the Shares will be the monetary consideration specified in the Sale Proposal increased by the market value of the non-monetary consideration;
- (b) an offer to acquire from the assignor assets used in the F3Business, and the Franchisor gives notice under clause 0, the Franchisor must buy those assets; and
- (c) an offer to acquire from the assignor other assets, the Franchisor may elect to buy some or all of those assets. The price payable by the Franchisor for those assets will be their market value.

24.4 Submission of future Sale Proposals

The Franchisor's election not to operate the Franchise or acquire the Shares in accordance with this clause does not affect the obligation to submit future Sale Proposals to the Franchisor.

F4

S. 7.1: By Franchisor. The Franchisor may at any time transfer the benefit and the burden (if any) of this Agreement to another person without notice to the Franchisee.

S. 7.2. Transfer by Franchisee or Guarantor. The Franchisee's and Guarantor's Obligations under this Agreement cannot be transferred or assigned without the consent of the Franchisor and their Obligations under this Agreement will not be discharged, released or affected by a transfer or assignment of this Agreement.

F5

-Franchisee will not unreasonably withhold consent if--

- (a) Franchisee is not in breach of the agreement or has remedied any breach.
- (b) Franchisee has paid or made reasonable provision to pay all that is owing under the

agreement and any agreement relating to the franchise.

- (d) the new Franchisee or the current Franchisee has paid the transfer fee.
- (e) Franchisee is not in breach of lease, licence etc. and the LL has given consent to the sale of the business."

Transfer of Franchise

- (f) Franchisee has paid all money owing to suppliers.
- (g) The proposed transferee is of good moral character, financially secure, has adequate experience and resources to operate a franchise and meets any other selection criteria imposed by the Franchisee."
- (h) Franchisee has satisfied all obligations under the franchise code.
- (i) The proposed Franchisee enters into an agreement or gives security.
- (j) the proposed transfer does not have an adverse effect on the franchise system.

F6

15.1 By franchisor

This Deed and all the rights and obligations created under or pursuant to this Deed is fully assignable by F6 to a suitably experienced, financially stable, and competent person or entity, in whole or in part and will continue to the benefit of any assignee or other legal successor to F6 interest herein. F6 will remain liable for any non-performance which occurred prior to the date of assignment. The Franchisee must execute any assignment agreement or deed requested by F6 or its assignee within seven (7) Business Days of receiving such agreement or deed. If the Franchisee fails to execute such agreement or deed within the period set out in this clause, the Franchisee appoints any director of F6 as its attorney and agent to execute on its behalf any such agreement or deed.

15.2 By the franchisee

- (a) The Franchise is personal to the Franchisee and may not be transferred or assigned in any way (whether in part or in whole) by the Franchisee, including, without limiting the generality thereof, by devolution on the death of the Franchisee to one or more beneficiaries of the Franchisee's estate.
- (b) Subject always to the right of first refusal referred to in clause 15.4, the Franchisee may sell or transfer the Local Assets to a third party (the "transferee") subject to the written approval of franchisor. F6 may withhold its consent to such sale or transfer if any of the following conditions are not complied with:
 - (1) the transferee meets franchisor requirements as to suitability, financial stability, ability, experience and compatibility;
 - (2) the Franchisee pays to franchisor:
 - (A) all unpaid accounts in respect of purchases of Approved Ingredients; and
 - (B) the amount of any commission or brokerage payable by F6 to any business broker, agent or consultant appointed by F6 to sell the Local Assets on behalf of the Franchisee if so requested by the Franchisee and any costs incurred by F6 in advertising the Local Assets for sale on behalf of the Franchisee;
 - (3) the transferee executes documents required for effecting the transfer of the Local Assets, (including, without limitation, the business name and trademark documents);
 - (4) the Franchisee complies with the disclosure obligations contained in clause 12 of the Code;
 - (5) where the transferee is a corporation, the directors and the shareholders of the transferee providing guarantees and indemnities to F6 on terms acceptable to F6 and the Nominated Manager of the transferee being acceptable to franchisor;
 - (6) F6 in writing approving the terms and conditions of the sale or transfer of the Local Assets;
 - (7) the proposed transferee or the guarantors proposed by the transferee (where the transferee is a corporation) may not be or have been a franchisee or licensee of F6 or any of its master franchisees or have been connected with or had a direct or indirect interest in a franchisee or licensee of F6 or its master franchisees;

- (8) the transferee executing franchisor Standard Franchise Deed or Agreement (identified by franchisor) and such other documentation and agreements as are required by F6 at the time of the transfer of the Local Assets (which shall include the then current levels of franchise service fees, advertising contributions and other charges applicable to new franchises and franchisees) and the payment by the transferee of any Initial Fee charged by franchisor.
- (9) if required by franchisor the transferee agrees to upgrade, refurbish and redesign the Premises in order to ensure that the Premises conforms to and complies with the then current F6 IMAGE, or such other image that F6 is required to conform with to meet the requirements of the lessor of the Premises.
- (c) The Franchisee must within one (1) month of the completion of the transfer of the Local Assets provide to F6 a copy of its annual accounts (prepared in accordance with clause 8.1) for the period from the commencement of the financial year in which the transfer takes place until the date of completion of the transfer of the Local Assets.
- (d) The Franchisee must within one (1) week of the completion of the transfer of the Local Assets, provide F6 with any reports not yet submitted in terms of clause 8.3 together with payment of any amounts due to franchisor.
- (e) The Franchisee must ensure that immediately prior to any sale or transfer of the Local Assets taking place, all of the equipment, fixtures and fittings, signage, air conditioning, electrical fittings and wiring, plumbing and drainage, shop fittings and joinery and any other physical items which are included in the Local Assets and contained in the Premises and being transferred, are in proper working order and condition and are in a good state of repair and appearance. The Franchisee agrees that an amount equivalent to ten percent (10%) of the sale price of the Local Assets, but subject to a minimum of ten thousand dollars (\$10,000.00) must be deducted from the sale price of the Local Assets and paid by the transferee to F6 and held in a separate bank account. Thirty (30) Business Days after the transfer of the Local Assets has taken place, the amount so held, less the **REASONABLE** cost of repairing or making good any Local Assets that are found not to be in proper working order and condition or in a state of disrepair, unserviceable or damaged immediately after the sale or transfer has taken place, and subject to the Franchisee and the transferee complying with all terms and conditions of clause 15.2(b), will be paid by F6 to the Franchisee.
- Such portion of the cost of refitting the Premises after sale or transfer of the Local Assets to meet the then current F6 IMAGE, or to meet the lessor's requirements, other than of a repair nature, shall not be deducted by F6 when the refund to the Franchisee in terms of this clause is made.
- (f) Prior to the commencement of business by the transferee, the transferee and its Nominated Manager must complete a training program to the complete satisfaction of franchisor.

15.3 Death of franchisee

- (a) If the Franchisee is a natural person, then upon the death of the Franchisee, the executor or legal personal representative ("**executor**") of his estate may only transfer the Local Assets (including, without limitation, a transfer of the Local Assets by devolution on the death of the Franchisee to one or more beneficiaries of the Franchisee's estate) with the prior written consent of F6 and on terms and conditions determined by F6 in its absolute discretion.
- (b) If the executor of the Franchisee's estate wishes to sell or transfer the Local Assets to a third party (who is not a beneficiary of the Franchisee), the executor must within twenty-one (21) Business Days of the death of the Franchisee first offer the Local Assets in writing to F6 at a price equal to the fair market value of the Local Assets and on such other terms as the third party is prepared to accept. Any dispute as to the determination of the fair market value will be referred to expert determination in accordance with clause 23. F6 will have for a period of twenty-one (21) Business Days from the date of delivery of such offer, the right, but not the obligation, exercisable by written notice, and delivered to the executor to accept the offer to purchase the Local Assets at the fair market value and on the other terms set out in the written offer.
- (c) F6 may deduct from the price any unpaid debts, including any unpaid Franchise Service Fees and Advertising Contributions owed by the Franchisee to F6 and may also pay out of the price any of the Franchisee's unpaid trade or other creditors.

- (d) If F6 fails to accept the offer within the period of time set out in this clause, then the executor will only be permitted to sell or transfer the Local Assets to the third party if and only if the executor (on behalf of the Franchisee) observes and complies with all the provisions of clauses 15.2(b) to and including 15.2(f) which will be deemed to be expressly incorporated into this clause with the modifications as the contract requires.
- (e) If the Franchisee is a corporation and any of the Guarantors die, or suffer permanent incapacity (the Franchisee or Nominated Manager (as appropriate) dies or becomes incapacitated (the latter of which will be deemed to have occurred if franchisor and the Franchisee receive written advice from a registered medical practitioner approved by franchisor stating that such disability has continued or is likely to continue for a period in excess of six (6) weeks or that the Franchisee or Nominated Manager suffers from an illness or injury (whether physical or mental) of such nature that the time for cure or recuperation cannot be estimated) or are bankrupted (the **“Incapacitated Guarantor”**), the Franchisee must upon such acceptance notify F6 in writing and within fourteen (14) Business Days of notifying F6 in writing of the occurrence of any of those events:
- (1) provide the name of a person or persons (the **“Replacement Guarantor”**) to assume all the duties and obligations of the Incapacitated Guarantor under or pursuant to this Deed and the Deed of Guarantee and Indemnity and prove to the satisfaction of F6 that the proposed Replacement Guarantor is a suitable, sound, respectable, responsible, solvent and financially stable person with at least a similar level of ability and experience in operating a business such as the Franchised Operation as the Incapacitated Guarantor had; and
 - (2) procure that the proposed Replacement Guarantor enters into a covenant with F6 in the form required by F6 to the effect that he will duly perform and observe the covenants and provisions to be performed and observed by the Incapacitated Guarantor under this Deed and Deed of Guarantee and Indemnity; or
 - (3) advise F6 that it wishes to sell or transfer the Local Assets to a third party, in which event the provisions of clause 15.3(b) and 15.2(e) will with the necessary modifications, apply.

15.4 franchisor right of first refusal

- (a) If the Franchisee at any time wishes to sell or transfer the Local Assets, the Franchisee must obtain a bona fide, executed written offer (the **“Offer”**) to purchase the Local Assets from a responsible and fully disclosed third party (who is not related or in any way associated with the Franchisee). The Franchisee must submit an exact copy of the Offer, together with an itemised schedule of the Local Assets to be sold, to franchisor who shall, for a period of twenty-one (21) Business Days from the date of delivery of the Offer, have the right, but not the obligation, exercisable by written notice to the Franchisee, to purchase the Local Assets, for the price (less any sales commission which would have been payable as a result of the proposed sale) and on terms and conditions contained in the Offer.
- (b) F6 may substitute cash for any form of non-cash payment proposed in the Offer. If there is a dispute as to the true value of any non-cash payment set out in the Offer such dispute will be referred to expert determination in accordance with clause 23. F6 may deduct from the purchase price any unpaid debts, including any unpaid Franchise Service Fees and Advertising Contributions owing by the Franchisee to F6 and may pay out of the price any of the Franchisee’s unpaid trade or other creditors. In addition the conditions of clause 15.2(e) will apply.
- (c) If F6 does not exercise its right of first refusal within the period of time set out in clause 15.4(a), the Franchisee may sell or transfer the Local Assets to the transferee subject to the Franchisee complying with the provisions of clause 15.2(b) to and including 15.2(f) for a price which does not vary by more than five percent (5%) from the price set out in the written offer. If the sale or transfer to the third party is not completed within two (2) months after delivery of the Offer to franchisor. F6 shall again have the right of first refusal herein provided.

15.5 franchisor **right of first refusal upon guarantor's sale of shares**

- (a) Subject always to the provisions of clause 21.1, where the Franchisee is a corporation and the Guarantor or Guarantors wish to sell or transfer fifty percent (50%) or more of the issued share capital in the Franchisee, or transfer any number of shares in the Franchisee that will cumulatively result in fifty percent (50%) or more of the issued share capital having been sold or transferred to a third party (who is not related or in any way associated with the Guarantors or the Franchisee), the Guarantor or Guarantors must obtain a bona fide, executed written offer (the “**Share Offer**”) to purchase from the third party all the Guarantor's shares in the Franchisee (which will constitute all the issued share capital of the Franchisee). The Guarantors must submit an exact copy of the Share Offer to franchisor, who shall, for a period of twenty-one (21) Business Days from the date of delivery of the Share Offer, have the right, but not the obligation, exercisable by written notice to the Guarantor or Guarantors, to purchase all the said shares, for the price (minus any sales commission which would have been payable as a result of the proposed sale) and on the terms and conditions contained in the Share Offer.
- (b) F6 may substitute cash for any form of non-cash payment proposed in the Share Offer. If there is a dispute as to the true value of any non-cash payment such dispute will be referred to expert determination in accordance with clause 23. F6 may deduct from the purchase price any unpaid debts and unpaid Franchise Service Fees and Advertising Contributions owed by the Franchisee to F6 or the Guarantor or Guarantors to franchisor, and may pay any outstanding trade or other creditors of the Franchisee out of the price. In addition the conditions of clause 15.2(e) will apply.
- (c) If F6 does not exercise its right of first refusal within the period of time set out in clause 15.4(a), the Guarantor or Guarantors may complete the sale of the said shares to the third party, (subject to the Guarantor or Guarantors and the Franchisee first complying with the provisions of clauses 15.2(b)(1) and (2) as if the third party were the transferee), and subject to the Franchisee complying with the provisions of clause 15.2(b) to and including 15.2(f) for a price which does not vary by more than five percent (5%) from the price set out in the Share Offer but otherwise on the same terms and conditions. The Franchisee and the Guarantor or Guarantors must procure the execution by the directors and shareholders of the third party of a deed of guarantee and indemnity in favour of F6 in the form stipulated by franchisor. If the sale to the third party is not completed within two (2) months after delivery of the Share Offer to franchisor, F6 shall again have the right of first refusal herein provided.
- (d) Before the date of entry into such sale of shares to F6 pursuant to clause 15.5(a), the Guarantor or Guarantors must provide F6 with a Statutory Declaration detailing all existing debts and liabilities of the Franchisee. The Guarantor or Guarantors must indemnify and continue to indemnify F6 against any other debts or liabilities of the Franchisee which have not been disclosed in the Statutory Declaration.

F7

S. 29: Assignment, Merger or Acquisition by franchisor

S. 29.1: Assignment: The Franchisor may transfer all or any part of its rights, interests, obligations or liabilities under this Agreement by assignment.

S. 29.2: Novation: The Franchisor may transfer all or any part of its rights, interests, obligations or liabilities under this Agreement by novation.

S. 29.3: Refinancing and Restructuring: The Franchisee and the Guarantor acknowledge

that the Franchisor may, in addition to or as part of an assignment or novation ...

- (a) sell itself, its assets and any of the Intellectual Property which it owns to a third party;
- (b) engage in a private placement of some or all of its securities; and
- (c) undertake a refinancing, recapitalisation, leveraged buyout or other economic or financial restructuring.

S. 29.4: Acknowledgment and Agreement to Assignment: If the Franchisor elects to assign all or any part of its rights, interests, obligations or liabilities under this Agreement the Franchisee and the Guarantor must upon request by the Franchisor execute any deed, agreement or notice of assignment acknowledging and agreeing to such assignment by the Franchisor.

S. 29.5: Novation Agreement: If the Franchisor elects to transfer all or any part of its rights, interests, obligations or liabilities under this Agreement by novation to a third party the Franchisee and the Guarantor must upon request by the Franchisor execute a deed or agreement of novation, in a form prepared by the Franchisor substituting in place of the Franchisor a third party as being entitled and responsible for the rights, obligations and liabilities of the Franchisor under this Agreement.

S. 29.6: Merger: The Franchisor may purchase, merge, acquire or affiliate with an existing competitive or non-competitive franchise network, chain or any other business and:

- (a) operate, franchise or licence those businesses to operate using the Marks and Intellectual Property of the Franchisor from premises which may be located within the Territory; and
- (b) require the Franchisee to use or cease to use any Marks, corporate colours, trade dress, décor, uniforms, designs, appearances or attributes in accordance with clause 19.6.

S. 29.7: Consent: The Franchisee and the Guarantor consent to the Franchisor at any time assigning any of its rights, interests, obligations or liabilities under this Agreement or undertaking any of the actions outlined in clauses 0, 0, 0 and 0 and:

- (a) waive any requirement for prior notice to the Franchisee or Guarantor of any such action;
- (b) expressly and specifically waive any claims, demands or damages arising from or related to the loss of the Marks or the System and/or the loss of association with or identification of the Franchisor as the franchisor under this Agreement; and
- (c) expressly and specifically waive any and all other claims, demands or damages arising from or related to a merger, acquisition or restructure and any other claim of divided loyalty, breach of fiduciary duty, fraud, breach of contract, unconscionable conduct or unfair dealing.

ASSIGNMENT AND OTHER DEALINGS BY FRANCHISEE

S. 29.8: Acknowledgment by Franchisee: The Franchisee acknowledges that:

- (a) the Franchise has been granted to the Franchisee following a consideration by the Franchisor of the Franchisee's character, business experience and capability and financial capacity; and
- (b) because of this there are important restrictions in this clause 0 on the Franchisee's ability to deal with the Franchise and the Business.

S. 29.9: Prohibition against Assignment by Franchisee:

- (a) The Franchisee must not assign, sell or otherwise Dispose of its interest in the Franchise or the Business without first:
 - (i) offering to sell the Business to the Franchisor in accordance with clause 0; and
 - (ii) if that offer is not accepted, obtaining the Franchisor's consent which must not be unreasonably withheld if all of the conditions mentioned in clause 0 have been satisfied.
- (b) A request for the Franchisor's consent under clause 0 must be made in writing.
- (c) If the provisions of the Franchising Code of Conduct are in force and mandatory as at the date the Franchisor receives a request under clause 00, the Franchisor will be treated as having given that consent if the Franchisor does not, within 42 days after the request is made, give to

the Franchisee written notice:

- (i) that the consent is withheld; and
- (ii) setting out why the consent is withheld.

S. 29.10: Conditions to be satisfied before Assignment can be approved: The Franchisor must not unreasonably withhold its consent under clause 0 if the sale, assignment or other disposal is of the whole of the Franchisee's interest in the Franchise and each of the following conditions are satisfied:

(a) the Franchisee establishes to the Franchisor's REASONABLE satisfaction that the proposed assignee:

(i) possesses the financial resources necessary to conduct and operate the Business as a franchisee and to service any borrowings it makes in order to acquire the Business;

(ii) is a reputable and responsible person having the business experience and capabilities necessary to operate the Business successfully; and

(iii) otherwise meets the Franchisor's criteria for the selection of new ## Franchisees;

(b) the Franchisee pays to the Franchisor the Assignment Fee;

(c) the Franchisee, both when seeking consent to the assignment and when the assignment is to occur is not in default under this Agreement or any Related Agreement;

(d) at the option of the Franchisor, the assignee executes:

(i) a franchise agreement in the form then used by the Franchisor (which may contain different terms and conditions to those set out in this Agreement) for the balance of the Term (including any existing right of renewal for a further term); or

(ii) a deed of assignment of the Franchisee's rights and obligations under this Agreement to the assignee in a form required by the Franchisor, and the assignee executes any other documents then customarily used by the Franchisor for its ## Franchisees;

(e) where the assignee is a company:

(i) its directors and shareholders satisfy the criteria in clause 00; and

(ii) those directors and shareholders nominated by the Franchisor each give a guarantee and indemnity in favour of, and in a form required by, the Franchisor in respect of the assignee's obligations to the Franchisor;

(f) the assignee's proposed manager is approved by the Franchisor and successfully completes the Franchisor's training program for ## Franchisees;

(g) the Franchisee:

(i) gives to the Franchisor all details of the proposed assignment including a copy of the contract for the sale of the Business and any other agreements between the Franchisee and the assignee; and

(ii) sells to the assignee all of the Franchisee's essential assets used in the Franchise (including the assignment of any Occupancy Right);

(h) the Premises comply with the then prevailing Image; and

(i) the Franchisee establishes to the Franchisor's REASONABLE satisfaction that the proposed assignment will not have a significantly adverse effect on the ## System or the Network.

S. 30.4: Franchisor's Right of First Refusal

(a) This clause 30.4 applies if:

(i) the Franchisee wishes to sell the Business; or

(ii) clauses 8.5, 25.6 or 26.7 apply.

(b) For the purpose of this clause 30.4 "Offer Period" means the period of fourteen (14) days after the Franchisor receives the Offer Notice.

(c) If the Franchisee wants to:

(i) sell the Business; or

(ii) allow the Disposal of shares or units to a person who is not an existing shareholder in the Franchisee or unitholder in the Trust,

the Franchisee must first offer to sell the Business to the Franchisor by giving to the

Franchisor a written notice (“Offer Notice”) stating the price the Franchisee is willing to accept (“Offer Price”) and the terms and conditions of sale.

(d) The Franchisor may accept the offer contained in the Offer Notice by giving notice of acceptance to the Franchisee before the end of the Offer Period (“Acceptance Notice”).

(e) If the Franchisee receives the Acceptance Notice during the Offer Period the Franchisee must sell and the Franchisor must purchase the Business for the Offer Price and upon the terms and conditions contained in the Offer Notice.

(f) If the Franchisor does not accept the offer contained in the Offer Notice within the Offer Period the Franchisee is entitled to sell the Business or allow the Disposal of shares or units to a third party within 60 days after the end of the Offer Period as long as:

(i) the Franchisee complies with clauses 0 and 0; and

(ii) the sale or Disposal is not made for less than the Offer Price or on terms and conditions more favourable to the third party than those contained in the Offer Notice.

(g) If the Franchisee does not sell the Business or allow the Disposal of shares or units within the period referred to in clause 0 the rights of the Franchisor are revived and the Franchisee must not permit any sale or Disposal without first offering the Business to the Franchisor in accordance with this clause 0.

S. 30.5: No Encumbrances

(a) The Franchisee must not create or allow the creation of any Security Interest over this Agreement, the Franchise or the Business without first obtaining the Franchisor’s written consent.

(b) The Franchisor must not unreasonably withhold consent if the Franchisee gives to the Franchisor an acknowledgment from its lender in the form set out in Annexure B.

S. 30.6: No Sub-Franchises: The Franchisee must not lease, licence, franchise or part with possession of the Business or the Franchise without first obtaining the Franchisor’s written consent.

S. 30.7: Restructuring by Franchisee

If the Franchisee is made up of:

(a) 2 or more persons and one or more of them want to assign their interest in the Franchise to one or more of the others; or

(b) one or more individuals who want to assign the Franchise to a company beneficially owned by them and incorporated by them for the sole purpose of conducting the Business,

the Franchisor must not unreasonably withhold its consent to the assignment nor require payment of an Assignment Fee if each of the following conditions are satisfied:

(c) the assignor assigns to the assignee all of its interest in the Franchise, the Business and any Related Agreement;

(d) the assignment does not affect the assignor’s obligations to the Franchisor before the assignment;

(e) the Franchisor has been given details of the proposed assignment and any other details requested by the Franchisor at least 30 days before the proposed assignment is to take effect;

(f) the person or persons who will make up the Franchisee after the assignment have the financial capacity and the ability to operate the Franchise successfully without the assignor’s involvement;

(g) if the assignee is a company, the directors and the shareholders nominated by the Franchisor execute a guarantee and indemnity in favour of, and in a form required by, the Franchisor in respect of the obligations of the assignee to the Franchisor; and

(h) the Franchisee pays the Franchisor’s legal Costs (on a solicitor and own client or full indemnity basis, whichever is greater) in connection with the assignment.

S 30.8: Death or Permanent Incapacity

(a) If any of:

(i) a natural person Franchisee (where there is one or more of them); or
(ii) a director or shareholder of any Franchisee which is a body corporate, dies or suffers permanent incapacity, that person (or the person's executor or personal representative) must, within 4 months after the person dies or becomes permanently incapacitated, sell the Franchise and the Business or their interest in the Franchise and the Business.

(b) The provisions of this clause 0 apply to any sale under clause 0. For example, this means that:

(i) if ownership of the Business is to be restructured in the manner contemplated by clause 0, that clause applies; and

(ii) otherwise:

(1) the Franchisor has a right of first refusal to acquire the Business under clause 0; and

(2) the sale must meet all the requirements of clause 0.

(c) If the sale is not completed within the 4 month period referred to in clause 0 the Franchisor may terminate this Agreement and the Franchise by giving a written notice to the Franchisee.

(d) In this clause "permanent incapacity" happens if because of mental and physical infirmity the person cannot actively participate in the Business for a total of 60 days at any time or times during any consecutive 12 month period.

S. 30.9: Temporary Operation

(a) If:

(i) the Franchisee fails to keep the Business open during Business Hours; or

(ii) the Franchisee stops running the Business or abandons the Business or the

Premises; or

(iii) clause 0 applies and there has been no sale of the Business as required by

that clause,

the Franchisor may, but does not have to, operate and manage the Business until the end of the Franchise or until a sale is effected in accordance with clause 0.

(b) The Franchisor must account to the Franchisee for all net income received by the Franchisor while operating and managing the Business less a REASONABLE management fee. The Franchisee must bear any losses incurred during the Franchisor's operation and management of the Business.

(c) The Franchisor is not liable to the Franchisee in any way for anything done by the Franchisor while it operates and manages the Business in accordance with this clause 0.

S. 30.10: Temporary Management: If, in the opinion of the Franchisor, the Manager is unable to operate the Business through accident, ill-health, inability or for any other reason the Franchisor may, but does not have to, manage the Business on behalf of the Franchisee until the Manager is replaced and trained in accordance with clause 24.

S. 30.11: Conditions of Management

If the Franchisor manages the Business pursuant to clause 30.10:

(a) the Franchisor shall not be liable to the Franchisee for any loss or damage suffered by the Franchisee arising out of such management by the Franchisor;

(b) the Franchisee must indemnify the Franchisor and its employees and agents against all damages, sums of money, costs, charges, expenses, actions, claims, liabilities, injuries

and demands made against or suffered by the Franchisor, its employees or agents which arise out of such management; and

(c) the Franchisee must pay to the Franchisor REASONABLE fees prescribed by the Franchisor for managing the Business and any travelling, accommodation or other expenses in relation to such management.

5 Assignment

5.1 Prior Written Consent and Franchisor's First Right of Refusal – The Licencee shall neither sell, assign or transfer this Agreement or any right or interest therein or thereunder nor suffer or permit any such sale, assignment or transfer to occur without the prior consent of the Licensor first being obtained and subject to the Licensor's right of first option to purchase contained Clause 5.2

5.3 Terms and Conditions of Assignment – In the event the Licensor elects not to exercise its first option to purchase under Clause 5.2 the Licencee may sell or transfer its assets and the Licenced Operation to a bona fide purchaser for the price and under the same terms and conditions as previously offered to the Licensor upon the expiration of the Licensor's twenty (20) day acceptance period only if:

5.3.1 the Licencee is not in default under this Agreement or any other agreement between the Licensor and the Licencee;

5.3.2 all debts due and payable by the Licencee to the Licensor are paid in full by the Licencee;

5.3.3 the Licencee delivers to the Licensor complete details of the proposed Purchaser together with audited financial statements for the preceding two (2) years;

5.3.4 where the Purchase is a corporation, the majority of shares are held by a natural person;

5.3.5 the proposed Purchaser executes a Deed of Covenant to be bound by the Terms of this Agreement;

5.3.6 the Licensor being able to conduct an interview with the proposed Purchaser at a location chosen by the Licensor;

5.3.7 the Licensor, at its sole discretion, agreeing to the proposed Purchaser purchasing the Licenced Operation;

5.3.8 the Licencee paying to the Licensor the Transfer specified in Schedule 13.

Schedule Item 13: Transfer fee: 15% of the current Licence fee.

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14.1 Sale or Encumbrance

The Franchisee hereby acknowledges that the Franchisor has granted the rights granted to the Franchisee pursuant to this agreement because of among other things, the character, background and other qualifications and abilities personal to the Franchisee. Accordingly, the Franchisee hereby agrees that it will not sell, assign, transfer, mortgage, pledge, hypothecate, encumber, donate or otherwise deal with either the rights granted it under this agreement or any part of the Business, to any person, corporation or other entity (in this clause 14, the "Recipient") without the prior written consent of the Franchisor, which consent shall not be unreasonably withheld. Notwithstanding the foregoing but subject to the provisions of the Lease, the Franchisee shall be entitled to mortgage, pledge, hypothecate or encumber all or any of the assets of the Business without first receiving the consent of the Franchisor if such mortgage, pledge, hypothecation or encumbrance is made to a bank which is licenced to carry on a retail banking business in Australia for the purpose of obtaining financing for the Business. For the purposes of determining whether or not the Franchisor will grant its consent as provided herein, if anyone or more of the following conditions are not complied with at the time of the completion of the proposed sale, assignment, transfer, mortgage, pledge, hypothecation, encumbrance, donation or other dealing, any withholding of consent by the Franchisor as a result of such non-compliance shall be deemed to be a reasonable withholding of consent:

(1) with respect to any proposed sale, assignment, transfer, donation or other dealing (except in the circumstances provided in subclause (2) hereof):

(a) the Franchisee shall submit an application in writing to the Franchisor requesting the Franchisor's consent. Such application shall set out:

- (i) the exact terms of the proposed sale, assignment, transfer, donation or other dealing and shall include as an appendix therewith a copy of any offer with respect thereto,
- (ii) information relating to the business reputation and qualifications of the Recipient to carry on business,
- (iii) suitable credit and financial information of the Recipient to allow the Franchisor to make a reasonable decision as to the credit worthiness and financial position of the Recipient, and
- (iv) such other information as the Franchisee may have knowledge and would reasonably be considered of a relevant nature to the Franchisor in determining whether or not to grant its consent.

The Recipient must arrange to have a face to face interview with the Franchisor, at the Recipient's or the Franchisee's sole expense, prior to consent of the sale. This face to face interview cannot be combined with the training session noted in clause 14.1 (1)(b);

(b) the Recipient must arrange to take all or such training in the operations of the Business, at his or the Franchisee's sole expense, as the Franchisor deems necessary;

(c) the Recipient must not have a financial or other interest of any type, directly or indirectly, in any business operating in competition with or similar to the Business or any business of the Franchisor;

(d) the Recipient shall enter into any and all agreements and covenants (including a new franchise agreement) which the Franchisor is requiring of new franchisees at the time of the proposed sale, assignment, transfer, donation or other dealing; further, if the Recipient is a corporation or other entity, the Recipient shall provide such personal guarantees or other assurances of its shareholders or members or others as the Franchisor may require;

(e) the Franchisee shall have discharged and/or satisfied all of its obligations (financial or otherwise) to the Franchisor as at the date of the completion of the said sale, assignment, transfer, donation or other dealing;

(f) the Franchisee, any Guarantor hereto and if the Franchisee or such Guarantor is a corporation or other entity, their officers, directors, shareholders or members, shall execute and deliver to the Franchisor and F9, their officers, directors, shareholders, employees and their heirs, executors, administrators, successors and assigns, a general release in a form approved by the Franchisor and F9, releasing the Franchisor and F9 and the aforementioned from all claims, demands, liabilities, actions, damages, costs or expenses which the Franchisee, any Guarantor or any of their officers, directors, shareholders or members may have as a result of this agreement, the Business, or the relationship of the Franchisor, F9 and Franchisee created by this agreement;

(g) the Franchisee paying to the Franchisor, an amount equal to the greater of \$10,000 or 5% of the purchase price to be paid by the Recipient on account of such sale, assignment, transfer, donation or other dealing, such amount to cover all expenses (legal or otherwise) which may be incurred by the Franchisor in connection with the said sale, assignment, transfer, donation or other dealing; all expenses which may be incurred by the Franchisor in training or otherwise familiarising the Recipient with the F9 System; and generally to recognise the past efforts and contributions of the Franchisor.

- (h) all of the provisions of the Lease respecting sale, assignment, transfer, donation or other dealing shall be complied with;
- (i) any proposed sale, assignment, transfer, donation or other dealing must include all of the rights granted to the Franchisee hereunder and all of the assets of the Business; and
- (j) the Franchisee shall deliver to the Franchisor together with the Franchisee's application referred to in subclause (1)(a) above, the sum of \$1,000 to cover costs and expenses which may be incurred by the Franchisor in dealing with the said application of the Franchisee; such amount shall be non-refundable, but if the proposed sale, assignment, transfer, donation or other dealing is successfully completed, such sum shall be applied for the benefit of the Franchisee against the amount to be paid pursuant to sub-section (1)(g) above.

F10

S2.12 The Franchisee must not transfer, assign, otherwise encumber or licence another entity to operate the Franchise Business, except for those circumstances as set out in Clause 10.

F10

Surrender of Franchise in Favour of Named Person

8.1 If the Franchisee desires to sell all or part of the Franchised Business as a going concern, it will surrender the Franchise to the Franchisor, and obtain a re-grant of a franchise to the purchaser. Conditions are as follows.

Neither the Franchisee nor the purchaser, if a franchisee, are in breach of their Franchise Agreements.

The Franchisee submits an accurate list of Regular Clients serviced (if any)

The purchaser must satisfy all selection criteria of the Franchisor for the Franchise.

All payments by the purchaser, including those for goodwill and client base (but not equipment, provided this is valued at a fair market price), will be paid to the Franchisor who will hold them in trust. No interest is payable on this money.

After seven days the Franchisor may take out:

any money owing to the Franchisor;

any money owing to the bank for a business loan, where the Franchisor introduced the Franchisee to the lender or where the Franchisor is party, whether as surety or not;

20% of the total payment, as a fee due to the Franchisor.

After ten days the Franchisee will be given 50% of the total sum paid (minus any fees owed), if this much remains in trust, and provided they have eliminated all traces of signage on any retained vehicle or trailer, and presented these for inspection.

The remaining money will be released at 45 days, minus the following:

\$4,000, where the Franchisee's right to Work Guarantee has been terminated, but too few

regular clients make a Successful Transfer to terminate the new Franchisee's Work Guarantee.

Or, where no Regular Clients are involved, \$4,000 will be retained when the Franchisee's gross turnover on average for each month over the previous six months (net of stock) has been less than the work availability guarantee set out in Item 17 of the Schedule. This money goes into the Advertising Account, and allows the Franchisor to rebuild the business. It does not apply where the Franchisor's 20% fee is more than \$4,000.

(For businesses with Regular Clients) On or before sign-up by the Purchaser, a set number of regular clients must be identified as clients of the business. Where less than 90% of these clients

make a Successful Transfer, a fee based on the number short of the identified number, multiplied by the Client Good Will Value (Item 12 of the Schedule). For example, suppose that 100 clients are advertised and only 80 successfully transfer, and the value of a regular client is \$200. The fee in this case is \$200 by 20, or \$4,000. This money will be returned to the purchaser on the Franchisee's behalf, as compensation for the reduced value of the business.

The Franchisor may also hold back a Security Bond (Item 26 of the Schedule) for a period of not more than twelve months. The Franchisor may spend all or part of this on rectifying faulty work carried out by the Franchisee. After twelve months, any remaining money will be returned to the Franchisee.

The cost of re-spraying the Franchisee's trailer and/or work vehicle, if retained, and if this has not already been done and presented for inspection.

The Franchisor must provide the purchaser with a standard Work Availability Guarantee.

F11

34 Assignment and Right of First Refusal

34.1 Right of First Refusal – Subject to Clause 34.5, if the Coach decides to sell the Franchise and enters into a written agreement with a bona fide purchase, then the following conditions apply:-

- (a) The Coach must make a written offer to Franchisor to sell the Franchise to Franchisor. The written offer must be accompanied by an exact copy of the signed agreement and a schedule of assets to be sold with the Franchise;
- (b) If Franchisor wishes to accept the offer, Franchisor must notify the Coach in writing for within fourteen (14) days of the date of delivery of the written offer to Franchisor;
- (c) If Franchisor accepts the offer, then it will purchase the business and the assets for the consideration stated in the written agreement with the purchase less any sales commission payable and otherwise on the terms and conditions contained in the written offer;
- (d) Franchisor may allow a set off of any monies owing by the Coach to Franchisor or substitute cash for any form of payment proposed in the written offer. If there is any dispute as to the true value of any non-cash portion of the consideration then the value of the non-cash portion will be determined by a valuer appointed by the President of the Institute of Valuers in the State in which the Territory is situated;
- (e) Until the expiration of the fourteen (14) days, the Coach must not proceed with the assignment unless the offer is in the meantime unconditionally rejected by Franchisor in writing.

34.4 Conditions – Subject to Franchisor's right of first refusal under clause 34.1, the Coach must not assign, sub-let or transfer this Franchise or part with possession of the Business without the prior written consent of Franchisor except consent must not be arbitrarily or unreasonably refused or withheld if conditions listed in 34.4 (a) to (l) applies.

34.5 Schedule Item 8: Assignment Fee of \$5,000 and Training of Purchase \$5,000 is payable; a total of \$10,000 – (Whether GST is excluded in this amount is not stipulated).

35 Assignment by Franchisor

35.1 Conditions – Franchisor may assign this Agreement and Franchisor’ rights and obligations under this Agreement to any person who:

(a) is financially responsible and economically capable of performing the obligations of Franchisor under this Agreement, and

(b) expressly assumes and agrees to perform Franchisor’ obligations under this Agreement.

F12

Schedule Item 12, Transfer Fee: \$10,000 (Excl. GST)

10.1 Transfer

10.1.1 The Franchisee cannot sublicense this agreement.

10.1.2 The Franchisee must not transfer this agreement in whole or in part, or transfer any shareholding in any company that acts as Franchisee, without the Franchisor's consent.

10.1.3 A request for the Franchisor's consent to a transfer must be in writing.

10.1.4 The Franchisor must not unreasonably withhold consent to a transfer of the whole agreement.

10.1.5 Circumstances in which it is reasonable for the Franchisor to withhold consent to the transfer of the whole agreement include:

10.1.5.1 if the proposed transferee is, in the Franchisor's opinion, unlikely to be able to meet the financial obligations that the proposed transferee would have under this agreement;

10.1.5.2 the proposed transferee does not meet an obligation required by this agreement;

10.1.5.3 the proposed transferee has not met the selection criteria of the Franchisor (as specified in the Manuals or otherwise specified at any time by the Franchisor);

10.1.5.4 the proposed transferee is not appropriately qualified to carry on the Business;

10.1.5.5 agreement to the transfer will have an adverse effect on the " " System;

10.1.5.6 the proposed transferee does not agree in writing to comply with the obligations of the Franchisee under this agreement;

10.1.5.7 the Franchisee has not paid or made reasonable provision to pay an amount owing to the Franchisor; or

10.1.5.8 the Franchisee has breached this agreement and has not remedied the breach.

10.2 Requirements for transfer

10.2.1 Before a transfer of this agreement, in whole or in part is effected:

10.2.1.1 The Franchisee must pay to the Franchisor the Transfer Fee. The Franchisee acknowledges that this amount is reasonable to cover the Franchisor's cost of the transfer;

10.2.1.2 The proposed transferee or the proposed transferee's Nominated Operator must complete to the Franchisor's satisfaction any education and training courses the Franchisor considers necessary;

10.2.1.3 The proposed transferee must sign:

10.2.1.3.1 an agreement in a form acceptable to the Franchisor under which the Franchisor consents to the assignment to the proposed transferee of this agreement and the Franchisee's rights and obligations under this agreement; OR

10.2.1.3.2 at the Franchisor's sole discretion, a new franchise agreement on the Franchisor's then current terms; and

10.2.1.3.3 any other documents the Franchisor requires the Authorised Representative to sign.

These requirements in no way limits the Franchisee's obligation to comply with this agreement before transfer;

10.2.1.4 The proposed transferee must provide to the Franchisor a statutory declaration that the proposed transferee is not an undischarged bankrupt;

10.2.1.5 The proposed transferee must acquire all of the Franchisee's essential assets used in the Business and assume all the Franchisee's liabilities in respect of the Business;

10.2.1.6 The Premises must comply with the current “ “ Image;

10.2.1.7 The Franchisee must provide to the Franchisor a copy of the sale agreement for the Business at least 7 days before signing by any party;

10.2.1.8 The terms of sale agreement between the Franchisee and the proposed transferee must be acceptable to the Franchisor.

10.2.2 Clause 12.1, 12.3, 12.5 and 12.7 of this agreement apply to the Franchisee upon transfer of this agreement, as if the agreement expired or terminated.

10.2.3 The Franchisee must assist the transferee for a period of 90 days after the transfer of the agreement by:

10.2.3.1 introducing the transferee to as many of the clients of the Business as possible; and

10.2.3.2 assisting the transferee to learn the Franchisor's procedures and policies

10.3 Franchisor's right of first refusal

10.3.1 If the Franchisee wishes to sell the Business or any part of it (referred to hereafter in this clause as "the Business"), the Franchisee must obtain an executed written offer (showing the name of the offeror) in that regard and deliver a copy of that offer to the Franchisor.

10.3.2 Within 21 days after delivery, the Franchisor may give notice to the Franchisee that the Franchisor will buy the Business on the same terms as the offer. However:

10.3.2.1 The price is reduced by any sales commission saved by the Franchisee;

10.3.2.2 The Franchisor may substitute cash for any non-cash consideration proposed in the offer. If the Franchisor and the Franchisee do not agree the value of non-cash consideration, the Franchisor may appoint an independent valuer to decide the value. The valuer is an expert, not an arbitrator. The decision of the valuer binds the Franchisor and the Franchisee. The Franchisor and the Franchisee must each pay one half of the valuer's fees;

10.3.2.3 The Franchisor may deduct from the price any debt of the Franchisee to the Franchisor or the trade creditors of the Business.

10.3.3 If the Franchisor does not give notice within 21 days, the Franchisee may proceed with the offer (even if the price is reduced by up to 5%).

10.3.4 If the sale is not complete within 90 days after Franchisee's delivery of the offer, this clause applies again as if a new offer to the Franchisee has been made.

10.3.5 The Franchisee may agree to sell the property subject to the previous clause and this clause.

10.3.6 If the Franchisor gives notice under clause 10.3.2, the Franchisee may elect, by written notice to the Franchisor, to withdraw the property from sale. If that occurs the Franchisee must not at any time afterwards sell the property or any part of it without first complying with this clause.

10.4 Transfer by Franchisor

10.4.1 The Franchisor may transfer or encumber its interest this agreement in whole or in part.

10.4.2 The Franchisee's consent to such transfer or encumbrance will not be required and to the extent necessary, and provided that the Franchisor obtains a commitment or undertaking that the transferee will abide by the Franchisor's obligations pursuant to this agreement, the Franchisee hereby consents to any such transfer.

10.4.3 This agreement is fully transferable (without requiring the consent of the Franchisee) by the Franchisor in whole or in part and shall (upon the Franchisee being notified of the transfer) continue to the benefit of any transferee or other legal successor to the interest of the Franchisor provided that the Franchisor shall, subsequent to any such transfer, remain liable for any non-performance of its obligations contained in this agreement and incurred to the date of transfer. Upon the transfer, the Franchisor is released from all liability under this agreement arising on and after the date the transfer takes effect.

10.4.4 If requested by the Franchisor or the transferee, the Franchisee must sign and return within 14 days after receipt a transfer agreement acceptable to the Franchisor.

F13

S9.1 Request for transfer -Franchisee must forward a request for consent to the transfer in writing and must also give Franchisee a written offer as Franchisee have offered the other person.

S117 Franchisee may transfer interest in this agreement. Upon transfer Franchisee will no longer be liable under the terms of the agreement provided that another Franchisee can be found who agrees to bound by agreement to Franchisee. Withholding consent re: transfer S126 h) Franchisee has satisfied all obligations under the franchise code.

S9.2 Within 30 days, Franchisee will advise in writing of if it will accept the offer.

S9.3 Despite s9.1 and s9.2, Franchisee may enter into contract of sale which is conditional upon Franchisee failing to accept the offer. S9.4 Even if Franchisee does not accept the offer, Franchisee must not transfer or attempt to transfer without Franchisee's written consent -- Consent will not be unreasonably withheld.

S9.5 F13 may withhold consent if:

- (a) The proposed transferee is unlikely to be able to meet the financial obligations; or
- (b) The proposed transferee has not met the selection criteria of the Franchisee;
- (c) Agreement to transfer will have a significantly adverse effect on the franchise system; or
- (d) The proposed transferee does not enter into a confidentiality agreement at the time nominated by the Franchisee.
- (e) The proposed transferee does not agree in writing to comply with Franchisee's obligations under the franchise agreement
- (f) Franchisee has not paid or made reasonable provision to pay an amount owing to Franchisee
- (g) Franchisee has breached the agreement and has not remedied the breach.

F14

Schedule Item 16: Transfer Fee: An amount equal to 4% of the price for which you sold the Business

43. If you wish to sell your Business the following provisions shall apply:

Must offer Business to us first

(a) you must first offer the Business to us by writing to us and stating the price that you wish to sell your Business and the terms for payment of the price. Within 21 days of receiving your letter we will advise you in writing:

- (1) whether we will accept your offer; or
- (2) alternative terms upon which we would be prepared to purchase your Business ("a counter offer"); or
- (3) whether we are agreeable to you placing the Business on the open market for sale.

(b) If we do not respond to your letter of offer within 21 days we will agree to you placing the Business on the open market for sale.

(c) If we submit a counter offer, you must within 14 days of receiving our counter offer advise us in writing whether or not you accept the counter offer. If you do not accept the counter offer we will agree to you placing the Business on the open market for sale.

(d) If we accept your offer or you accept our counter offer a binding contract will come into existence once such acceptance is communicated to the other party. Despite this, we will engage our solicitors to prepare a formal contract recording the terms negotiated which each of us will sign within 7 days of such formal contract being presented for signing.

Conditions on sale to third party

(e) Any sale of your Business must be conditional upon our approval of the purchaser as a franchisee. We may withhold such approval if any of the circumstances described in Section 20(3) of the Code exist. We will not unreasonably withhold such approval provided all of the circumstances described in Section 20(3) of the Code do not exist and;

(1) You and the purchaser demonstrate to us that the purchaser (and if the purchaser is a company, its directors and shareholders) are reputable, responsible and solvent;

- (2) The purchaser (and if the purchaser is a company, its directors and shareholders) have in our opinion sufficient experience and completed sufficient training to enable them to adequately run a F14 Business and comply with the terms of the franchise agreement then being used by us;
- (3) Either:
- (A) a deed of assignment of this franchise in a form approved by us is executed by you, the purchaser and us (supported by a guarantee executed by the directors and shareholders of the purchaser, if the purchaser is a company); or
- (B) we and you enter into an agreement in a form approved by us terminating the franchise granted under this Agreement and we and the purchaser entering into a new franchise agreement on the terms then offered by us to franchisees (supported by a guarantee executed by the directors and shareholders of the purchaser, if the purchaser is a company) for a term ending not prior to the date the term of this Agreement would otherwise have come to an end;
- (4) The owner of the Business Premises consents to the purchaser commencing business as our franchisee from the Business Premises (if such consent is necessary under the terms of our lease of the Business Premises);
- (5) You pay us at or prior to the completion of the sale:
- (A) the transfer fee specified in Item 16; and
- (B) an amount equal to all legal costs and expenses we incur arising out of the sale of your Business; and
- (C) any money which you owe us; and
- (D) an amount necessary to enable us on your behalf to repay any debts owed to your suppliers.

F15

Schedule Item 14: \$15,000 Transfer Fee.

8.3 Transfer Fee. In the event that:

- (a) the Franchisee wishes to assign the Franchised Operation in accordance with Clause 9, the Franchisee shall pay to the Franchisor the Transfer Fee to the Franchisor;
- (b) the assignment does not for any reason whatsoever proceed, then the Franchisor shall refund to the Franchisee the Transfer Fee less such reasonable costs and expenses (including legal costs) of the Franchisor associated with the training of the proposed Assignee or the preparation of documentation to give effect to the assignment.

9. ASSIGNMENT

9.1 Not assign. The Franchisee is not entitled to and covenants that it will not assign or purport to assign this Franchise or sell the Franchised Operation without the prior consent in writing of the Franchisor, which consent and approval shall not be unreasonably withheld in the case of a reputable, responsible, solvent Assignee who is capable of operating a F15 Shop and complying with the terms of the franchise agreement and who successfully completes the Initial Training.

9.6 Transfer Fee. In the event of a proposed assignment the Franchisee shall pay to the Franchisor the Transfer Fee together with the reasonable costs of and incidental to such an assignment, the deeds of covenant and guarantee referred to in Clause 9.5 prior to the commencement of any training by the proposed assignee and shall pay to the Franchisor prior to

the date of the assignment a Performance Bond which shall be used to payout any outstanding liabilities of the Franchisee. The balance of the Performance Bond shall be paid to the Franchisee within one (1) month of the assignment or such reasonable time thereafter having regard to the purpose of the Performance Bond. Should liabilities exceed the Performance Bond, then the Franchisee shall pay to the Franchisor, such additional amounts, within seven (7) days of the written request from the Franchisor or its solicitor.

12.13 Franchisor Assignments. The Franchisor retains the right to sell any or all of the Names and Marks and retains the right to assign its rights in and to this Agreement upon such terms as it deems appropriate in its absolute discretion subject to the assignee assuming all the future obligations due to the Franchisee under this Agreement and written notice by the Franchisor, of such assignment, to the Franchisee, will be conclusive and official evidence of such assignment.

F16

PART 13 ASSIGNMENT

13.1 Franchisor's consent required

Franchisee acknowledge that the rights and duties created by this agreement are personal to the Franchisee, and that the Franchisor has entered into this agreement in reliance upon the individual or collective character, skill, aptitude, attitude, business ability and financial capacity of the Franchisee and/or its owners. Accordingly, the Franchisee must not:

- (a) purpose or purport to effect any sale, transfer, mortgage, charge, assignment, sub-licence, declaration of trust or any other legal or equitable disposition of the Franchisee's rights or any part thereof.
- (b) If the Franchisee is a corporation, suffer any change in or appointment of directors of the Franchisee;
- (c) If the Franchisee is a corporation, resolve to or permit the issue of allotment of any shares in the Franchisee or approve the registration of the transfer of any shares in the Franchisee if this would result in a change of effective control of the Franchisee from that existing on the date of this agreement;
- (d) If the Franchisee is a trustee of a trust, permit the transfer of any units or beneficial interest in the trust if this would result in a change in the effective control of the trust from that existing on the date of this agreement.

13.2 Franchisor must not unreasonably withhold its consent to an assignment where the following conditions are met:

- (a) the assignee meets the Franchisor's selection criteria, is likely to be able to meet the financial obligations under the Master Franchise Agreement and has met all the reasonable requirements of the Franchisor;
- (b) the Master Franchisee pays to the Franchisor its costs of evaluation of the proposed transferee, its directors, officers, employees, shareholders and proposed guarantors.

- (c) Where it is proposed that the specified person will change, the proposed new specified person must have been approved by the Franchisor and have successfully completed training.
- (d) The Franchisee must not be in default under this agreement and must have paid in full all amounts owed.

13.3 Right of First Refusal

If any assignment is proposed, the Franchisee must first offer the interest to the Franchisor on no less favourable terms.

13.4 Death or disability of Franchisee

Upon the death or permanent disability of the Franchisee or the specified person, the Franchisor may in its sole and absolute discretion allow the Franchise to continue to operate provided a competent manager is retained to run the Franchise pending sale or transfer of the Franchise and that Manager becomes the Specified Person.

- 13.5 If Franchisee wishes to advertise by any media for the purpose of effecting an assignment, sale or other disposition, the Franchisee shall, prior to any such advertising submit the form and/or text of any proposed advertisement for the written approval of the Franchisor, which approval shall not be unreasonably withheld.

13.7 Assignment by Franchisor

The Franchisor may transfer or assign some or all of its rights, benefits and obligations under this agreement, together with the benefit of any guarantees given on account of the Franchise and the same will enure to the benefit of any assignee or other legal successor to the interest of the Franchisor.

F17

29.9 Sale of your business - A sale and purchase of your business under this Part will be on the following terms unless waived in writing by us:

- the price and its apportionment is to be the agreed price and/or apportionment between you and us or the relevant price and apportionment as decided by the expert under this Part;
- the sale is to be made under the standard contract for the sale of a business approved by the real estate institute of the state or territory in which your business is located or if there is no such contract, the standard contract of sale of business approved by the Queensland Law Society with any necessary changes and with any special conditions needed to give effect to this Part and on the basis that the contract is subject to the buyer arranging finance from a bank in a sum reasonably sufficient to settle the relevant dealing and if we require, including a condition requiring you to surrender your interest in this franchise agreement and/or a transfer or surrender of your sublease;
- the contract for the sale of your business is to include a general release on terms we approve releasing and discharging us and our associates from any liabilities, claims or actions that you or your associates may have against us, our associate, our directors, shareholders or employees in connection with the original acquisition of your business and/or your franchise and/or the investment made by your associates in connection with your business and/or your franchise or for any loss or damage suffered by you or your associates in connection with your business or dealings or transactions made under or in connection with this agreement or the transaction documents;

- you must do everything and sign all documents to transfer your business to us or our nominee free of encumbrances;
- settlement of the contract for the sale of your business is to happen within 60 days of a contract for the sale of your business being received by you and the price and its apportionment having been agreed or decided by the expert under this Part.

PART 34 DEALINGS - EG SALE OF YOUR BUSINESS

34.1 Restrictions

Unless allowed under this agreement, you and your associates must not, during the franchise term, without our consent:

- part with, share possession or sell your business or the store;
- transfer or charge your store premises agreements or grant a sublease, licence or sublicense or other rights to anyone else to possession, use or occupation of the store;
- create or allow to come into existence a mortgage, charge or encumbrance over you, your business, your assets or the ownership interest of your associates except under the permitted encumbrances; and
- sell, allot, issue, mortgage or deal with any of the ownership interests of you or your associates in you or your associates or in trusts of which you or your associates are a trustee or in any trust that hold interests in any of those trusts.

34.2 For the purposes of this agreement, a dealing in the ownership interest in you includes the registration of any transfer of shares, the amendment to the memorandum or articles of association which increases your unauthorised capital, creates a new class of shares or varies the rights attaching to any shares or the issue of any shares to anyone who was not previously a shareholder or any change in the beneficial ownership of shares.

34.3 Right of first refusal

If during the franchise term, you or your associates wish to sell your business, your assets, or the ownership interests of one or more of your associates to a third party, you and/or your associates (as the case requires) must first give us a sale notice. If we are interested in exercising our right of first refusal, we may require you to give us full details in writing of all terms of the proposed dealing together with the names of the proposed buyer and other parties to the proposed dealing. You or your associates are to provide us with any information we reasonably require to evaluate any offer from a third party if we request it within 14 days of getting details of the proposed dealing. We may, by delivering written notice within 30 days from delivery to us of all necessary details about the proposed dealing, tell you whether we or our nominee wish to buy your business, your assets or the ownership interests of one or more of your associates for the price and on the terms referred to in the sale notice or in the other documents that have been supplied to us. If we wish to exercise the right of first refusal, we will reasonably consider requests which you or your associates may make as to the methods of settling the proposed dealing but we do not have to complete a dealing involving the sale of your business in a form other than an asset purchase. If we exercise our right of first refusal, we will have at least 60 days to prepare for completion of the dealing and the relevant contract will be subject to finance for an amount reasonably necessary to complete the transaction and will, if we require, include a condition requiring you to surrender your interest in this agreement.

34.4 6 month sale period

If we or our nominee do not exercise the right of first refusal in clause 34.3, you and your associates will have 6 months to complete a sale of your business or your assets or a sale of the ownership interests of one or more of your associates to someone approved by us in line with the requirements for dealings in this Part 34. If a contract for the sale of your business or a contract for the sale of an ownership interest of your associates does not settle within the said 6 months or if the terms of the dealing previously disclosed to us are substantially and materially changed, we or our nominee will again have a right of first refusal on the same terms as in clause 34.3 with any necessary changes.

34.5 We will not exercise a right of first refusal with respect to a proposed transfer of an ownership interest of less than 20% to a member of the immediate family of any of your associates where the transfer is due to the death or disability of anyone or more of your associates.

34.6 Dealings

We will not unreasonably withhold consent to a proposed dealing under clause 34.1. It will be reasonable for us to withhold our consent to a proposed dealing until the following conditions are met.

To the full extent permitted by law, a proposed dealing will be subject to the rights of first refusal or options to buy your business or an ownership interest of one or more of your associates.

To obtain our consent to a proposed dealing:

- you or a party to each proposed dealing must give us 30 days written notice of each proposed dealing;
- you or a party to each proposed dealing must give us the details of all the parties to each proposed dealing we require. Details we may require may include the name of the parties to the proposed dealings, their business address, references, statements of assets and liabilities, company and trust documents;
- you or a party to each proposed dealing must give us a copy of all agreements for each proposed dealing between you, your associates and all parties to each proposed dealing;
- you or a party to each proposed dealing must pay us a reasonable administration charge of up to \$750 plus GST to consider the proposed dealing irrespective of whether the proposed dealing proceeds. This administration charge may be deducted from the sale fee if the proposed dealing is completed;
- the parties to each proposed dealing must be able to meet the financial obligations that the parties to each proposed dealing have or will assume as a result of each proposed dealing;
- you or the parties to each proposed dealing must prove to us that any proposed new franchisee meets the selection criteria for a new franchisee of a F17 store in Australia and that any associates of any proposed new franchisee also meets the selection criteria applicable to associates of a new franchisee of a F17 store in Australia;
- you or your associates must not be in default under this agreement, the transaction documents or any other agreement with us, your creditors or suppliers before and on settlement of each proposed dealing;
- you must pay us all the money due to us under this agreement and the transaction documents at the completion of each proposed dealing or make provision to pay all money due to us in a way satisfactory to us; you or a party to each proposed dealing must prove to us that a proposed new franchisee, its associates and each party to each proposed dealing:
 - are of good character, reputable, responsible and solvent:

- have the necessary resources and abilities to own and properly operate your business
- will comply with the obligations that they will assume as part of each proposed dealing.
- you or a party to each proposed dealing must prove to us that each proposed dealing will not have a significantly adverse effect on the system:
- you or a party to each proposed dealing must prove to us that all the parties to each proposed dealing have complied with their obligations at law. in connection with each proposed dealing including any disclosure obligations for each proposed dealing:
- you or a party to each proposed dealing must pay all reasonable legal costs incurred by us for each proposed dealing and the cost of preparation of any contracts or equipment for each proposed dealing:
- you or a party to the proposed dealing must pay the sale fee on or before the settlement of each proposed dealing where the dealing involves the transfer of your business or the transfer of a substantial ownership interest of one or more of your associates. If you have paid the reasonable administration charge referred to earlier, this may be deducted from the sale fee that may be required to be paid under this agreement;
- you and the parties to each proposed dealing must sign a contract or agreement for each proposed dealing on the conditions we reasonably approve.

34.8 Sale fee

A sale fee is payable to us under this Part in consideration of the costs of handling the proposed dealing and in consideration of us agreeing to consent to the proposed transfer or other dealings and/or us or our associates entering into a new franchise agreement and/or transaction documents with a new franchisee, its associates and other parties to any dealing.

F18

14 Transfer Assignment

14.1 F18 may at any time transfer or assign its rights pursuant to this Agreement and this Agreement shall enure to the benefit of any transferee or assignee, and to any subsequent successors in title. The Franchise Owner shall on request execute any assignment or novation documentation requested by F18.

14.2 The Franchise Owner shall not sub-licence or sub-contract the rights or responsibilities of the Franchise Owner under this Agreement.

14.3 The Franchise Owner shall not sell, transfer, mortgage, charge, encumber or otherwise deal with the Franchise without the prior written consent of F18, which consent will not be unreasonably withheld. In the case of a sale or transfer F18 will not withhold its consent provided: -

- (a) the transfer or assignment includes all of the Income Stream from the Franchise Owner's Designated Contracts and is part of a bona fide sale of the Income Stream to a purchaser, and is documented by a contract which provides the purchaser with the protection of an appropriate restrictive covenant and is in accordance with the standard F18 precedent sale agreement;
- (b) the proposed assignee or transferee is a responsible and solvent person with sufficient financial and business capacity to properly deal with the Designated Contracts and meets the Standards and criteria prescribed by F18 for new Franchise Owners;

- (c) the proposed new Franchise Owner and the proposed new Nominated Representative first obtain all accreditations, qualifications, licences, authorities and permits required to operate the Franchised Business in accordance with this Agreement and undertake at the cost of the Franchise Owner all training programs required by F18 of new Franchise Owners;
- (d) the Franchise Owner first pays to F18 the reasonable legal, training and other costs of the assignment;
- (e) the proposed new Franchise Owner and the Nominated Representative first execute F18's then current standard Franchise Agreement, all Collateral Agreements, any associated guarantees and otherwise comply with any pre-conditions to the grant of a Franchise imposed upon existing or new Franchise Owners of F18;
- (f) the Franchise Owner and the Nominated Representative are not in default under any provision of this Agreement or any other agreement between F18 and the Franchise Owner and the Nominated Representative and shall have substantially complied with all the terms and conditions of such agreements during the terms thereof;
- (g) there are no monies outstanding owed by the Franchise Owner or the Nominated Representative to any company within the F18 Group under this Agreement or any other agreement with the Franchise Owner, the Nominated Representative or any of the Principals.

14.4 Any change or changes in ownership, shareholding, unitholding, beneficial interest or expectancy, directorship or control of any Franchise Owner that is a corporation which themselves or in aggregate result in a change of majority beneficial ownership or control of the Franchise Owner from that existing on the Commencement Date shall be a deemed transfer and automatically subject to the foregoing requirements. Any such deemed transfer must satisfy the requirements contained in clause 14.3 .

F19

19. TRANSFER OF BUSINESS

- (a) The Company may Transfer this agreement.
- (b) The Member may not Transfer the Business or offer or attempt to Transfer the Business to any person except in accordance with the terms of this clause 19.
- (c) The Member must not Transfer this agreement without the prior written consent of the Company, which consent must not be unreasonably withheld by the Company subject always to the provisions of the Code.
- (d) It shall be reasonable for the Company to withhold its consent to any proposed Transfer of this agreement if:
 - (i) the proposed transferee is unlikely to meet the financial obligations that the proposed transferee would have under this agreement; or
 - (ii) the proposed transferee does not agree in writing to comply with the obligations of the Member under this agreement; or
 - (iii) the proposed transferee fails to meet the Company's then current selection criteria to become a Member.
- (e) If the Member intends to Transfer the Business (or any part of the Business) during the Term, the Member must notify the Company of its intention to Transfer ("Transfer Notice").

(f) The Transfer Notice must attach a business sale agreement ("Business Sale Agreement") with the proposed transferee ("Member's Nominee") which contains all the terms and conditions upon which the Member wishes to sell the Business including:

- (i) the total purchase price of the Business;
- (ii) the apportionment of the purchase price among the assets of the Business;
- (iii) the proposed settlement date;
- (iv) provisions in relation to the assignment of the Lease (if any), stock, employees, adjustments;
- (v) if applicable, an obligation on the Member's Nominee to assume (in a form requested by the Company) the obligations of this agreement or execute an agreement in the same or similar form as this agreement; and
- (vi) provisions in relation to other matters usually dealt with in business sale agreements.

(g) The terms and conditions contained in the Business Sale Agreement must not be any more onerous than the terms and conditions upon which the Member would offer to Transfer the Business to any person if not for the terms of this clause 19.

(h) Within 28 days from the day the Company receives the Transfer Notice ("Nomination Period") the Company must notify the Member ("Transfer Response") that:

- (i) the Company consents to the Transfer of this Agreement to the Member's Nominee; or
- (ii) the Company does not consent to the proposed Transfer to the Member's Nominee.

(i) In the event that the Company does not consent to the proposed Transfer to the Member's Nominee, the Company may attach to the Transfer Response a notice nominating a third party to whom the Member must offer to Transfer the Business on substantially the same terms as the Business Sale Agreement ("Nomination Notice")

(j) Nomination Notice must contain the following information:

- (i) the full name of the person nominated by the Company ("the Company's Nominee");
- (ii) the residential address (if a natural person) or the registered office address (if a company) of the Company's Nominee;
- (iii) the address for the service of notices to the Company's Nominee.

(k) The Member must within 28 days of receiving the Nomination Notice offer to Transfer the Business to the Company's Nominee Officer").

(l) The Offer must:

- (i) be given to the Company's Nominee at the address for service specified in the Nomination Notice;
- (ii) be given together with 3 copies of the Business Sale Agreement duly executed by the Member; and
- (iii) contain a statement to the effect that the Member offers to sell the Business to the Company's Nominee on the terms and conditions contained in the Business Sale Agreement.

(m) The Offer must state the period for which it is open for acceptance by the Company's Nominee ("Acceptance Period"). The Acceptance Period must not be less than 28 days from the date the Company's Nominee receives the Offer.

(n) During the Acceptance Period, the Member must:

- (i) co-operate with the Company's Nominee;

- (ii) provide to the Company's Nominee all accounts, financial statements, information and documents of the Business; and
- (iii) give the Company's Nominee reasonable access to the Location and the assets of the Business

in order for the Company's Nominee to assess whether or not to accept the Offer.

(o) Any notice given by the Company's Nominee will be taken to be given in accordance with this clause 19 if the notice is given in accordance with the notices provision (clause 21) of this agreement.

(p) If, in the Transfer Response:

- (i) the Company does not nominate a person as the Company's Nominee;
- (ii) the Company notifies the Member of a Company Nominee and the Company's Nominee fails to accept the Offer within the Acceptance Period; or
- (iii) the Company notifies the Member of a Company Nominee and the Company's Nominee rejects the Offer;

the parties agree that:

(iv) within 28 days of the last to occur of the events in clause 19(p)(i), (ii) or (iii) the Member may execute the Business Sale Agreement with the Member's Nominee and notify the Company of this event and of the scheduled date for completion under the Business Sale Agreement ("BSA Completion Date");

(v) this agreement shall terminate upon receipt of the notice by the Company of the BSA Completion Date; and

(vi) notwithstanding the termination of this agreement the Member will continue to pay to the Company the Membership Fees under this agreement in respect of the period to the end of the Term or to the first anniversary of the BSA Completion Date, whichever is the first to occur.

(q) If, in the Transfer Response, the Company consented to the proposed Transfer to the Member's Nominee the Member may proceed to Transfer the business to the Member's Nominee on the following basis:

(i) within 28 days of receipt by the Company of the Transfer Notice the Member must execute the Business Sale Agreement with the Member's Nominee and notify the Company of this event and of the scheduled date for completion under the Business Sale Agreement ("BSA Completion Date"); and

(ii) on or before the BSA Completion Date the Member will, procure the Member's Nominee to assume (in a form requested by the Company) the obligations of this agreement or execute an agreement in the same or similar form as this agreement.

APPENDIX C

CONTRACT TERM: TERMINATION

F1

Franchisee shall be deemed to be in default under this Agreement, and all rights granted to Franchisee herein shall automatically terminate without notice to Franchisee, if Franchisee shall become insolvent or make a general assignment for the benefit of creditors; or if a petition in bankruptcy or winding-up is filed by Franchisee or such a petition is filed against Franchisee and not discharged within thirty (30) days; or if Franchisee is adjudicated a bankrupt or insolvent; or if a bill in equity or other proceeding for the appointment of a receiver of Franchisee or other custodian for Franchisee's business or assets is filed and consented to by Franchisee; or if a receiver, liquidator or other custodian (permanent or temporary) of Franchisee's assets or property, or any part thereof, is appointed by any court of competent Jurisdiction or by a secured creditor of Franchisee or if proceedings for a composition with creditors under any state or federal law should be instituted by or against Franchisee; or if a final judgment against Franchisee affecting the Store remains unsatisfied or of record for thirty (30) days or longer (unless supersede as bond is filed); or if Franchisee is dissolved; or if execution is levied against the Store and not removed within thirty (30) days; or if suit to foreclose any lien or mortgage against the Premises or its equipment is instituted against Franchisee and not dismissed within thirty (30) days; or if the real or personal property of the Store shall be sold after levy thereupon by any bailiff, sheriff, marshal or constable; or if any security over the Premises or other property in the State is enforced.

Franchisee agrees to perform and comply with all of the obligations under the Lease and to pay, when due, all rent and other charges payable under the Lease. Franchisee acknowledges that the selection of the Premises as a Store location is an integral part of the System and that continuation of the Lease is essential to the Franchise. Failure to comply with the provisions of the Lease will, at F1' or Sub-Franchisor's election, constitute a breach of this Agreement. If the Lease is terminated for any reason, and F1 or Sub-Franchisor have given the Franchisee reasonable notice that F1 or the Sub-Franchisor propose to terminate the Agreement because of the breach, and have informed the Franchisee of what F1 or the Sub-Franchisor require to be done to remedy the breach, and that breach has not been remedied within a reasonable time but in no circumstances more than thirty (30) days, this Agreement will terminate immediately.

Franchisee shall be deemed to be in default under this Agreement upon the occurrence of any of the following events, and F1 or Sub-Franchisor may, at its option, terminate this Agreement and all rights granted Franchisee hereunder, without affording Franchisee any opportunity to cure the default, effective immediately upon receipt of notice by Franchisee.

If Franchisee fails to close and suspend operation of the Store when required by F1 or Sub-Franchisor under the terms of Section 8.4;

If Franchisee at any time ceases to operate or otherwise abandons the Store (any unapproved closure of 24 hours or more shall be deemed to be an abandonment), or loses the right to possession of the Premises, or otherwise forfeits the right to transact business in the Jurisdiction where the Store is located; provided, however, that if, through no fault of Franchisee, the Premises are damaged or destroyed and repairs or reconstruction cannot be completed within ninety (90) days thereafter, then Franchisee shall have thirty (30) days after such event in which to apply in such form as F1 may reasonably require for F1' approval to relocate and/or reconstruct the Premises, at Franchisee's sole expense, which approval shall not be unreasonably withheld, but may be conditioned upon the payment by Franchisee of an agreed minimum royalty during the period in which the Store is not in operation;

If Franchisee or any officer of Franchisee involved in the business of the Store is convicted of a felony, a crime involving moral turpitude, or any other crime or offence that F1 believes is reasonably likely to have an adverse effect on the System or the Products, the Proprietary Names and Marks, the goodwill associated therewith, or F1' interest therein;

If Franchisee permits the use of the Store or Premises for any illegal or unauthorised purpose, including, without limitation, palming or passing off or substitution of Products under the Proprietary names and Marks or other marks of F1;

If a threat or danger to public health or safety results from the maintenance or operation of the Store or the Premises;

If Franchisee offers for sale or sells unauthorized Products or services from the Store;

If Franchisee or any partner or shareholder in Franchisee purports to transfer any rights or obligations under this Agreement or any interest in Franchisee to any party without F1' and Sub-Franchisor's prior written consent, contrary to the terms of Section 18;

If Franchisee fails to comply with the covenants set forth in Section 15;

If, contrary to the terms of Section 5.4 or Section 11, Franchisee discloses or divulges trade secret provided to Franchisee by F1 or Su b-Franchisor to their material detriment, as determined by them, in their sole discretion:

If an approved transfer is not effected within a reasonable time following a relevant person's death, disability or mental incapacity, as required by Section 19;

If Franchisee knowingly maintains false books or record, or knowingly submits any false reports to F1 or to Sub-Franchisor;

If Franchisee, after curing an individual event of default pursuant to Section 16.4, commits the same default again, whether or not cured after notice;

If Franchisee repeatedly is in default under section 16.4 for failure substantially to comply with any of the requirements imposed by this Agreement, whether or not cured after notice; or

If any other F1 franchise agreement entered into by Franchisee is terminated by reason of Franchisee's default thereunder.

Except as otherwise provided in Sections 16.1 to 16.3, or unless Franchisee agrees to immediate termination of the Agreement, upon any default by Franchisee, F1 (or Sub-Franchisor with the concurrence of F1) may terminate this Agreement by giving Franchisee reasonable written notice of termination stating the nature of the default and indicating what Franchisee must do to remedy that default. F1 (or Sub-Franchisor) will give Franchisee reasonable time, but in no circumstances more than thirty (30) days, to remedy that default. Franchisee may avoid termination by curing the default within reasonable period of time and by promptly providing proof of cure to F1. If any default is not cured within reasonable time, this Agreement shall terminate without further notice to Franchisee on expiration of the reasonable period of time. Examples of events which will lead to termination under this Section include;

If Franchisee fails to comply in good faith with any of the requirements imposed upon it by this Agreement or fails to comply with the Standards;

If Franchisee fails, refuses or neglects promptly to pay any monies owed by it to F1, Sub-Franchisor or Lessor, or their subsidiaries or affiliates, when due, to make contributions or

expenditures for advertising as required under this Agreement, or to submit the financial or other information required by F1 or Sub-Franchisor under this Agreement ;

If Franchisee fails, refuses or neglects to obtain any prior written approval or consent as required by this Agreement ;

If Franchisee misuses or makes any unauthorised use of the Proprietary Names and Marks, or otherwise impairs the goodwill associated therewith or F1' rights therein;

If Franchisee engages in any business or markets any service or product under a name or mark which, in F1 opinion, is confusingly similar to the Proprietary Names and Marks; or if Franchisee fails to obtain execution of the covenants required under Section 15.9.

Franchisee recognises that the Store is one of the large number of F1 stores within the System selling similar Products and services to the public; hence, Franchisee's failure to comply with the terms of this Agreement would cause irreparable damage to F1, Sub-Franchisor and to the System. Therefore, in the event of a breach or threatened breach by Franchisee of any of the terms of this Agreement, Sub-Franchisor and/or F1 shall forthwith be entitled to an injunction restraining such breach and/or to a decree of specific performance, without showing or proving any actual damage or irreparable harm or lack of an adequate remedy at law, and without the requirements for the posting of bond, or other security for costs the same being hereby waived by Franchisee, until a final determination is made by a court of competent jurisdiction. The foregoing remedy shall be in addition to all other remedies or rights which Sub-Franchisor or F1 might otherwise have by virtue of any breach of this Agreement by Franchisee.

If Franchisee fails to do or perform any thing or act required on its part after thirty (30) days written notice of default, Sub-Franchisor shall also have the right (but shall not be obligated) to cause such thing or act to be done, and Franchisee shall pay all costs incurred by Sub-Franchisor in the performance thereof.

The parties agree that the Franchising Code of Conduct as amended from time to time may take precedent over any of the above sub-clauses.

F2

Termination for Breach.

The Franchisor is entitled to terminate this Agreement by Notice if:

- (a) the Franchisee has breached the terms of this Agreement;
- (b) the Franchisor has given a Notice to the Franchisee to remedy the breach in accordance with Clause 21; and
- (c) the Franchisee has failed to remedy that breach within the time period prescribed in the Notice.

22.2 Termination - special circumstances.

The Franchisor is entitled to immediately terminate this Agreement without having to comply with the provisions of Clauses 21.2 and Clause 22.1 if the Franchisee:

- (a) no longer holds a licence that the Franchisee must hold to operate the Business;
- (b) becomes bankrupt, insolvent under administration or an externally administered body

corporate;

- (c) voluntarily abandons the Business or the Franchise relationship;
- (d) any of its directors is convicted of a serious offence as defined in the Code;
- (e) operates the Business in a way that endangers public health or safety;
- (f) is fraudulent in connection with the operation of the Business; or
- (g) agrees to the termination of this Agreement.

22.3 Termination by Franchisee.

If:

- (a) the Franchisee is in substantial compliance with this Agreement;
- (b) the Franchisor breaches a material term of this Agreement; and
- (c) the Franchisee:
 - (i) informs the Franchisor of the breach;
 - (ii) gives REASONABLE Notice that it proposes to terminate this Agreement because of the breach;
 - (iii) provides details of the breach and what it requires the Franchisor to do to remedy the breach; and
 - (iv) allows the Franchisor thirty days to remedy the breach; and
- (d) the Franchisor fails to remedy that breach within thirty days after receiving Notice from the Franchisee of that breach,

then the Franchisee may terminate this Agreement by delivering 14 days Notice

F3

The following are Events of Default:

if the Franchisee:

- submits to the Franchisor a licence application or supporting information containing false or misleading statements or omissions of fact;
- does not open the Location for business within three months after the date of this agreement;
- does not rectify any failure to operate and maintain the F3Business strictly in accordance with this agreement as required by a notice from the Franchisor requiring rectification;
- sells or provides at or from the F3Business any products or services not approved by the Franchisor and continues to do so for five days after receiving notice from the Franchisor requiring the Franchisee to stop selling those products and to stop providing those services;
- does not provide items required by the Franchisor and continues to fail to do so for five days after receiving notice from the Franchisor requiring those products to be provided;
- does not pay any sum due under this agreement within seven days after receiving notice from the Franchisor requiring payment;

- assigns or purports to assign the Licence without complying with clauses
 - becomes bankrupt, unable to pay its debts as they fall due, or enters into any form of insolvency administration;
 - encumbers or purports to encumber the Licence without the Franchisor's approval;
 - does not maintain the licences (including any liquor licences) necessary to operate the F3Business;
 - abandons the F3Business or ceases or threatens to cease to operate the F3Business or to occupy the Location, without the Franchisor's approval;
 - breaches any other provision of this agreement and fails to remedy the breach within seven days after receiving notice requiring it to do so;
 - engages in any conduct, that in the Franchisor's opinion may adversely affect the System or the F3Business;
- by the Franchisee's inaction adversely affects, in the Franchisor's opinion, the System or the F3Business;
- fails to maintain a good credit rating by failing to pay promptly undisputed invoices from suppliers of goods and services to the F3Business;
 - fails to make any payments due to the Franchisor in excess of \$24,000 whether under this agreement or otherwise within 14 days of becoming due; or
 - fails to comply with one or more requirement of this agreement or the Operations Manual whether or not that non-compliance is corrected after notice on two or more occasions within any three month period.

if in the Franchisor's reasonable opinion the transfer of any interest in any share of the Franchisee or the variation of the rights attaching to the shares of the Franchisee results in the effective control of the Franchisee being transferred to a competitor of any F3Business.

Termination for default

If an Event of Default occurs and:

the Event of Default is not a breach of this agreement, the Franchisor may, by giving a reasonable period of notice, setting out the reasons for termination of this agreement, terminate this agreement upon expiry of the notice; and

the Event of Default is a breach of this agreement:

the Franchisor may give the Franchisee a notice:

- specifying the Event of Default and that the Franchisor proposes to terminate the agreement because of the breach;
- identifying what the Franchisor requires the Franchisee to do to remedy the Event of Default; and
- nominating a reasonable period which need not exceed 30 days (Cure Period) to remedy the Event of Default, and
- if the Event of Default is not remedied, in accordance with paragraph (B) within the Cure Period, the Franchisor may, by a further notice, terminate this agreement.

F4

S.29 Termination

S. 29.1 The Franchisee may terminate this Agreement within any mandatory cooling off period required by law to be given to the Franchisee by the Provision of written notice by the Franchisee to the Franchisor.

S. 29.2: If this Agreement is terminated in accordance with clause 29.1, the Franchisor will refund to the Franchisee any payments made by the Franchisee to the Franchisor less an amount not exceeding \$15,000.00 plus GST to cover the Franchisor's reasonable costs and expenses of:

- (a) evaluating the Franchisee

- (b) The negotiation, preparation, execution and stamping of this Agreement, the Disclosure Statement, lease of the Premises and any other documents;
- (c) Training the Franchisee or its Nominated Manager or other representatives;
- (d) Evaluation and carrying out any works to the Premises.

S. 29.3: The Franchisee may terminate this Agreement by written notice to the Franchisor if:

- (a) the Franchisor is materially in breach of any of the terms and conditions of this Agreement;
- (b) the Franchisee gives a written notice to the Franchisor specifying the failure to comply, if capable of remedy, specifying how the breach can be remedied and requiring remedy within a reasonable period not exceeding 30 days having regard to the nature of the breach; and
- (c) the Franchisor fails to remedy the same within the required period.

S.29.4: The Franchisor may terminate this Agreement by written notice to the Franchisee if:

- (a) the Franchisee fails to comply with any of the terms and conditions of this Agreement or the Operations Manual; and
- (b) the Franchisor gives a written notice to the Franchisee specifying the failure to comply, if capable of remedy, specifying how the breach can be remedied and requiring remedy within 30 days; and the Franchisee fails to remedy the same within 30 days.

S. 29.5: The Franchisor may terminate this Agreement immediately upon delivery of written notice of termination to the Franchisee if the Franchisee or any Guarantor commits, permits or suffers any of the following acts, events or omissions:

- (a) no longer holds a licence that the Franchisee must hold to carry on the Franchised Business;
- (b) becomes bankrupt, insolvent under administration or an externally-administered body corporate;
- (c) voluntarily abandons the Franchised Business or the franchise relationship.
- (d) is convicted of a serious offence;
- (e) operates the Franchised Business in a manner that presents a health or safety hazard to its customers, employees or the public;
- (f) is fraudulent in connection with the operation of the Franchised Business; or
- (g) agrees to termination of this Agreement.

S. 29.6: In addition, the franchisor may terminate this Agreement upon reasonable written notice of termination to the Franchisee if the Franchisee or any Guarantor commits, permits or suffer any of the following acts, event or omissions each of which shall constitute a material breach of this Agreement, including if the Franchisee or Guarantor:

- (a) files or is the subject of a petition for voluntary or involuntary winding up or if any resolution is passed or proceedings commenced for its winding up; or
- (b) a liquidator, provisional liquidator, receiver, receiver and manager or administrator is appointed to or exists in relation to any of its assets or undertaking; or
- (c) has served or suffers service of any execution, levy, or distress against the assets of the Franchised Business; or
- (d) makes an assignment or any other arrangement for the benefit of creditors of the Franchised Business or makes any composition or arrangement with such creditors or is unable to or deemed to be unable to pay its debts; or
- (e) makes an assignment of the Franchise Agreement without first complying with the provisions of the Agreement; or
- (f) abandons or surrenders or transfers control of its Franchised Business or fails actively to carry on the Franchised Business and such condition continues for only two days after notice of such default is given, unless the following occurs:
 - (i) war or civil disturbance;

- (ii) natural disaster;
 - (iii) labour dispute; or
 - (iv) other event beyond the Franchisee's reasonable control.
- (g) permits to occur or suffers a substantial change in the management, or any change in the ownership or control of the Franchisee which is not first disclosed to and approved in writing by the Franchisor; or
- (h) declares any trust otherwise creates any beneficial interest in its Franchised Business or any part of the assets of its Franchised Business without the prior written consent of the Franchisor; or
- (i) any Guarantor dies or suffers permanent incapacity; or
- (j) fails or refuses to submit any report, financial statement or other financial information or supporting records required pursuant to this Agreement, or submits such reports more than seven days late on more than three occasions during any twelve month period; or
- (k) submits any financial report which understates Gross Sales unless the Franchisee demonstrates to the Franchisor's satisfaction that such an understatement is a result of genuine and honest mistake; or
- (l) fails or refuses to pay any amount(s) owed to the Franchisor under the terms of this Agreement within 3 days of the due date for payment; or
- (m) sells or offers for sale, displays or holds anywhere in Australia for sale, any similar products to the Franchisor's Products and fails to cease such sale or offering for sale or fails to remove such products from the Premises any where else where the products are being sold, displayed, or held within three days following receipt of notice from the Franchisor requiring it to do so, or, having ceased to do so recommences to do so at any time following receipt of such notice from the Franchisor.

F5

If you: fail to make any payment to us under this or any other agreement, or fail to submit any report when required, or any of the persons identified in item 16 breach their non competition covenant, then we may:

- (i) give you notice specifying the breach;
- (ii) tell you what we require to be done to remedy that breach; and
- (iii) tell you that we propose to terminate the agreement if you do not remedy the breach as required by us within 14 days.

If the breach is a failure to perform any other obligation under this or any other agreement we may give you notice specifying the breach, telling you what we require to be done to remedy the breach and telling you that we propose to terminate the agreement if you do not remedy the breach as required by us within 30 days or lesser period as is deemed by us to be reasonable and appropriate in the circumstances.

If the breach is not remedied within the designated time limit we may, by notice to you, end this agreement.

Notwithstanding 139, 140 and 141, we may end this agreement immediately by notice if you:

- no longer have a right to occupy the premises for the conduct of the franchise business; or
- become bankrupt, insolvent under administration, or an externally administered body corporate; or
- voluntarily abandon the franchise business or the franchise relationship, or
- are convicted of a serious offence; or
- operate the franchise business in a way that endangers public health or safety; or
- are fraudulent in connection with the operation of the franchise business; or
- agree to the termination of this agreement.

Automatic termination

F6 may immediately terminate this Deed without any notice if the Franchisee:

- (a) no longer holds a licence that the Franchisee must hold to carry on the Franchised Operation; or
- (b) becomes bankrupt, insolvent, under administration by an externally administered body corporate; or
- (c) voluntarily abandons the Franchised Operation or the Franchise relationship; or
- (d) is convicted of a serious offence; or
- (e) operates the Franchised Operation in a way that endangers public health or safety; or
- (h) is fraudulent in connection with the operation of the Franchised Operation; or
- (i) agrees to the termination of this Deed.

16.2 Other franchisee breaches

F6 may give notice to the Franchisee proposing to terminate the Franchisee's appointment under this agreement after any one of the following events occur:

- (a) the Franchisee, Nominated Manager or any of the Guarantors commits an act of bankruptcy;
- (b) the Franchisee has a Liquidator, Provisional Liquidator, Receiver or Receiver and Manager, Official Manager, Scheme Manager or other custodian (either temporary or permanent) appointed of its assets or any of them;
- (c) the Franchisee or any of the Guarantors makes any assignment for the benefit of its creditors or makes any composition or arrangement with such creditors;
- (d) the Franchisee or any of the Guarantors has any of its property seized under any distress or execution;
- (e) any report, financial statement or other information or supporting record is submitted by the Franchisee on more than two (2) occasions at any time during the Term which understates the Gross Revenue for any period unless the Franchisee demonstrates that such understatement resulted from inadvertent error;
- (f) there is a failure or refusal by the Franchisee to submit any report, financial statement or other information or supporting records required herein or the Franchisee submits such reports more than one (1) week late on more than two (2) occasions during any twelve (12) month period;
- (g) there is a failure or refusal to pay an amount owed by the Franchisee to F6 under this Deed or any other agreement within seven (7) days after its due date for payment (or, if no due date is expressed in this agreement, within 7 days after F6 issues a demand for payment), or the Franchisee fails to honour on more than two (2) occasions during the Term cheques presented for payment;

- (h) the Franchisee sells or offers for sale any unauthorised merchandise or service on more than two (2) occasions during any six (6) month period;
- (i) a violation of any law, ordinance, rule or regulation of any relevant authority in connection with the operation of the Franchised Operation and failure to correct such violation promptly after notification thereof from any source unless there is a bona fide dispute as to the violation or status of such law, rule or regulation and the Franchisee promptly resorts to the courts or other forms of appropriate jurisdiction to contest such violation or status;
- (j) default of the licence or the lease entitling F6or the head lessor to possession of the Premises or otherwise parts with possession excepting in the case of destruction of the Premises caused by factors beyond the Franchisee's control;
- (k) the Franchisee does or attempts or purports to do any act or thing, where the consent of F6is required without first obtaining such consent;
- (l) the Franchisee fails to comply with any term or provision of this agreement (other than a term relating to the payment of any money) or any provision of the Confidential Operations Manual and does not remedy such failure within fourteen (14) days after written notice of such failure to comply (which shall describe the action that the Franchisee must take) is delivered to the Franchisee;
- (m) the Franchisee, Nominated Manager or any of the Guarantors is convicted of any criminal (non-traffic) offence (other than a driving under the influence offence);
- (n) any attempted Assignment or purported Assignment other than pursuant to clause 15.2;
- (o) subject to clause 15.3, the death of the Nominated Manager or a Guarantor;
- (p) a creditor enforces any security over any of the assets of the Franchisee;
- (q) the Franchisee is unable to pay its debts as and when they fall due, stops, suspends or threatens to stop or suspend payment of all or any of its debts;
- (r) the Franchisee committing an act or undertaking a course of conduct which F6considers as unsatisfactory performance of the Franchised Operation, as bringing F6into disrepute or as otherwise detrimentally affecting FRANCHISOR.
- (s) the Franchisee or the Nominated Manager failing to complete the initial training programme referred to in clause 10.1 to the REASONABLE satisfaction of FRANCHISOR.
- (t) the Franchisee failing to execute and have the Guarantors execute the licence by the Commencement Date.
- (u) the Franchisee failing to commence operating the Premises by the Commencement Date.

16.3 Rectification of franchisee default

- (a) This clause applies if:
 - (1) the Franchisee breaches this agreement; and
 - (2) F6gives a notice to the Franchisee under clause 16.2 proposing to terminate this agreement.

(b) F6 must:

(1) give to the Franchisee REASONABLE notice that F6 proposes to terminate the Franchise agreement because of the breach;

(2) tell the Franchisee what F6 requires to be done to remedy the breach; and

(3) allow the Franchisee a REASONABLE time to remedy the breach.

(c) In relation to paragraph (b)(3):

(1) F6 does not have to allow more than 30 days in the case of any breach;

(2) if the same breach occurs more than once within a period of 12 months, F6 does not have to allow more than 7 days in respect of the second breach; and

(3) if the same breach occurs more than twice within a period of 12 months, F6 does not have to allow more than 3 days in respect of the third or any subsequent such breach.

(d) Where a breach is incapable of remedy, the Franchisee must within 30 days after receiving a notice of breach take whatever action F6 reasonably directs to be taken in order to restore F6 to a position no less favourable than F6 was in before the breach occurred.

(e) If the breach is not remedied in accordance with paragraphs (b) and (c), or the Franchisee does not comply with FRANCHISOR' direction in accordance with paragraph (d), F6 may terminate this agreement by notice to the Franchisee.

17. TERMINATION BY FRANCHISEE

If the Franchisee is in substantial compliance with this Deed and F6 breaches a material term of this Deed and fails to correct such breach within fourteen (14) Business Days after written notice, sent by security post describing such breach is delivered to it, the Franchisee may terminate this Deed effective one (1) month after delivery to F6 of a written notice of termination. Any termination of this Deed by the Franchisee, except in accordance with this clause, shall be deemed to be a termination without proper cause and will be treated by F6 as a material breach or repudiation of this Deed by the Franchisee.

F7

Termination by the Franchisor for Franchisee's Default

The Franchisor may terminate this Agreement and the Franchisee if:

- a Default Event occurs; and

- the Franchisor gives to the Franchisee a written notice which:

- specifies the Default Event;

- tells the Franchisee what the Franchisor wants the Franchisee to do to remedy the Default Event;

- gives the Franchisee a REASONABLE time (which need not be more than 30 days) to remedy the Default Event; and

- states that the Franchisor proposes to terminate this Agreement and the Franchisee if the Default Event is not remedied within that time.

If the Franchisee remedies a Default Event in accordance with, and within the time allowed by, a notice issued under clause 0, the Franchisor cannot terminate this Agreement because of that Default Event.

Default Events

A Default Event occurs if:

- the Franchisee repudiates this Agreement;
- the Franchisee does not pay on time any money payable to the Franchisor under this Agreement or any Related Agreement;
- the Franchisee breaches any covenant, warranty, agreement or obligation contained or implied in this Agreement or a Related Agreement or imposed by law to be observed and performed by the Franchisee;
- any of the following occurs in respect of a body corporate which is a Franchisee or a Guarantor:
 - an application is made, proceedings are initiated or a meeting (whether of shareholders, creditors or directors) is called with a view to winding it or any part of its undertaking up or placing it or any part of its undertaking under administration;
 - an application is made or an action is initiated with a view to cancelling its registration or appointing an inspector or other officer to investigate any of its affairs, pursuant to any Law;
 - it is unable to pay its debts from its own money as and when they fall due; or circumstances exist which would enable the court upon application to order its winding up pursuant to section 461 of the Corporations Act;
 - in the case of a Guarantor which is a body corporate, it becomes an externally-administered body corporate;
 - if the Franchisee is a partnership, it is dissolved otherwise than in accordance with this Agreement or an application to a court for its dissolution is made;
 - a Guarantor becomes a bankrupt or an insolvent under administration;
 - a Guarantor is convicted of a serious offence;
 - distress is levied or an order, judgment or other process is issued against the Franchisee or a Guarantor or any of their assets for an amount exceeding \$5,000.00 which is not satisfied within 28 days;
 - the Franchisee's Occupancy Right is terminated due to some act or default on its part or the Occupancy Right expires and the Franchisee does not relocate the Business under clause 9.11; or
 - an event occurs entitling the Franchisor to terminate this Agreement under any other provision of this Agreement.
- The Franchisee and the Guarantor must immediately notify the Franchisor of the occurrence or likely occurrence of any Default Event.
- The Franchisee and the Guarantor must prevent the occurrence of a Default Event.

Immediate Termination

The Franchisor:

- may terminate this Agreement and the Franchise immediately by giving the Franchisee written notice; and
- does not have to comply with clauses 21 or 22 of the Franchising Code of Conduct, if the Franchisee:
 - no longer holds a licence that the Franchisee must hold to carry on the Business; or
 - becomes a bankrupt, an insolvent under administration or an externally-administered body corporate; or
 - voluntarily abandons the Business or the Franchise; or
 - is convicted of a serious offence; or
 - operates the Business in a way that endangers public health or safety; or
 - is fraudulent in connection with the operation of the Business; or
 - agrees to the termination of this Agreement and the Franchise.

Franchisor may rectify Franchisee's Default

- If the Franchisee does not perform or observe any obligation under this Agreement the Franchisor may, but does not have to, remedy that default. In doing so the Franchisor is entitled to rely on the power of attorney in clause 37.

9 Termination or Expiry

9.1 Upon the termination or expiry of this Agreement for whatever reason:

9.1.1 The Licencee shall at its own cost deliver to the Licensor any signs, Manuals, instructions, notes, writings and other documents relating to the Licenced Operation.

9.1.2 all rights granted by this Agreement with respect to the Marks and any other Intellectual Property shall revert to the Licensor;

9.1.3 The Licencee shall if require by notice in writing given by the Licensor remove, obliterate or destroy (as appropriate) any or all of the signs colour schemes and other features associated with the Licencee whether appearing at the premises from which the Licenced Operation is conducted or otherwise or shall permit the Licensor by its officers and agents to do so at the Licencee's costs;

9.1.4 the Licencee shall not be entitled to claim compensation from the Licensor or to receive any rebate or refund of any moneys expended by the Licencee for advertising or any other activates with respect to the Licenced Operation including moneys in any advertising fund or for the goodwill or any goodwill or which the Licencee may have established by its activities hereunder;

9.1.5 the Licencee pay any moneys due by the Licensor under this Agreement;

9.1.6 The Licencee shall pay the supplier of any Stock supplied to the Licencee and then remaining unpaid and such payment shall be made not later than seven (7) days after the date of termination of this Agreement;

9.1.7 the Licensor and the Licencee shall cooperate in the execution of any and all instruments necessary to complete the termination of this Licence;

9.1.8 the Licensor shall cease forthwith to use or display (whether by advertising or otherwise) any Business Name or any trade name or any of the Marks or any Intellectual Property or any imitation or approximation thereof in particular on the Premises, Signs, stationery or otherwise;

9.1.9 the Licence must supply to the Licensor the names of all persons being serviced or enquiring or requesting Products or Services forthwith on application being made by the Licensor;

9.1.10 the Licencee must return to the Licensor all copies, including all translated copies of the Manuals that are in the Licencee's possession or control;

9.1.11 the Licencee must return to the Licensor all stationery, promotional material, signs and other items in the Licencee's possession or under its control used in connection with the Licenced operation which bears the Business Name and/or any of the Marks and any of the Software Products provided by the Licensor to the Licencee.

9.2 The Licencee must not, after expiry or termination:

9.2.1 make or use in any manner any of the Marks or any name, slogan or device similar to the Marks or which may be confusing therewith or which may be reasonably considered to impute any association with the Licensor;

9.2.2 use directly or indirectly any Marks or Intellectual Right of the Licensor;

9.2.3 use or duplicate the Licenced Operation or the get-up or appearance of the Licenced Operation;

9.2.4 use for the benefit of the Licencee or other third any part of the Manual or any Confidential Information.

9.2.5 service or supply any product or service whatsoever offered by the Licensor on any similar product or service to any customer or potential customer of the Licenced Operation and refer all such customers or potential customers to the Licensor.

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8.5 Early Termination - If the term of the Lease or the Sublease terminates on a date more than 6 months prior to the date of termination of the original Term of this agreement as set out in clause 4.1 hereof, the Franchisee shall, provided it has not otherwise breached or, violated any of the provisions of this agreement and provided it has served notice to renew the agreement pursuant to the provisions of clause 4.2 hereof, have a period of 6 months from the date of the termination of the Lease or the Sublease, within which to relocate and again commence business from a location approved by the Franchisor, using the rights granted it pursuant to this agreement. If the Franchisee is unable to relocate and again commence such business within the aforesaid period, this agreement shall terminate and be of no further force or effect effective as of the end of the said 6 month period, and the Franchisee and the Guarantor agree that the Franchisor shall not be responsible for any losses, damages, costs or expenses whatsoever incurred by them as a result of such termination, it being hereby acknowledged that the Term of this agreement will not necessarily coincide with the term of the Lease or the Sublease. If the Franchisee is able to relocate, the Franchisee shall be required to obtain all prior consents and approvals of the Franchisor as provided by this agreement and this agreement and all of its provisions shall apply. All costs and expenses incurred with respect to any such relocation and recommencement of business shall be borne solely by the Franchisee. Otherwise, if the Lease or the Sublease terminates within a date 6 months prior to termination of the original Term of this agreement, and the Lease has not been renewed, then the Term shall be deemed to expire on the date of the termination of the Lease or Sublease, as the case may be, notwithstanding the termination date set out in clause 4.1 hereof and notwithstanding that the Franchisee has served notice of its intention to renew as I provided by clause 4.2.

12.1 Franchisee may terminate during Cooling Off Period

(1) The Franchisee may terminate this agreement and the Franchise by giving to the Franchisor a written notice of termination before the end of the cooling off period.

13. EFFECT OF TERMINATION

13.1 Effect

Forthwith upon the termination of this agreement for any reason whatsoever save and except in the event of termination pursuant to clause 8.3, 8.4 or 9.3(2) of this agreement wherein the provisions of the said clause 8.3, 8.4 or 9.3(2) shall apply, the following provisions shall apply:

- (1) all rights of the Franchisee under this agreement, including without limitation, the right to use the F9 System and the Trademark, shall cease forthwith, and thereafter the Franchisee shall cease conducting the Business or holding itself out to the public as being part of the F9 System, and shall cease using the Trademark for any purposes whatsoever;
- (2) the Franchisee shall forthwith deliver up to the Franchisor, the Manual and all other forms, documents, or information provided to the Franchisee pursuant to this agreement together with all copies thereof;
- (3) the Franchisee shall forthwith cease use of all telephone numbers and listing services in any way connected with the Business, and subject to the direction of the Franchisor, the Franchisee shall immediately cancel such numbers and listings or direct that same be transferred to the Franchisor, who then shall have the exclusive right to use such numbers and listings and/or authorize others to use same; if the Franchisee shall fail or refuse to cause the foregoing to be done, the Franchisee hereby irrevocably appoints the Franchisor as its lawful attorney to instruct the telephone company or listing service to cancel or transfer all such numbers or listings to the Franchisor or as it may direct;
- (4) the Franchisee shall forthwith cease to use all advertising, promotional or other material or identifying characteristics whatsoever identified with the F9 System and/or the Trademark and shall return same to the Franchisor upon request;
- (5) without limiting any other rights or remedies to which the Franchisor may be entitled, the Franchisee shall pay all amounts owing to the Franchisor pursuant to this agreement up to the date of termination;
- (6) (a) in the event the Franchisor holds the right to occupy the Premises as lessee or otherwise in the first instance, the Franchisee shall vacate the Premises forthwith upon the date of the said termination and until such time as the Franchisor determines whether or not it will exercise its option to purchase all or any part of the Products, Equipment and movable Leasehold Improvements or other assets hereinafter for the purposes specifically of this clause 13 to be referred to collectively as the "Property") as provided by clause 13.2(1) hereof, the Franchisee shall not remove same from the Premises. If the Franchisor does not exercise its said option to purchase all of the Property, the Franchisee shall then have 7 days from the receipt of notice from the Franchisor within which to remove all or that part of the Property from the Premises not being so acquired, failing which, the Franchisor may keep the Property on the Premises and use same itself or allow others to use such Property, or cause the same to be removed and stored at the sole cost and expense of the Franchisee; provided that if the Franchisee does not claim such Property within 30 days of receipt of such notice, the Franchisee shall lose all rights with respect thereto and the Franchisor shall be free to dispose of such Property as it shall desire without incurring any liability;
- (b) in the event the Franchisee holds the right to occupy the Premises as lessee or otherwise in the first instance, the Franchisor shall (if same has not previously been done) have the option, such option to be exercised in writing delivered to the Franchisee within 21 days of the date of the termination of this agreement (for the purposes of this clause, the said 21 day period to be referred to as the "Option Period"), to require the Franchisee to assign its interest in the Lease to the Franchisor or as the Franchisor may in writing direct. If the Franchisor does exercise its said option, the Franchisee shall execute and deliver such forms of assignment as the Franchisor may require, and unless the Franchisee has already vacated the Premises as provided hereinafter, the Franchisee shall vacate the Premises, within 3 days of the date that the Franchisor delivers its said notice. Subject to the decisions of the Franchisor as to whether or not it will exercise its option to have the Lease assigned to it as provided above and its option to purchase all or any portion of the Property pursuant to the provisions of clause 13.2, the Franchisee shall not remove any Property from the Premises, other than for the sale of those Products usually sold to the public in the ordinary course of the Business;

(c) in the event the Franchisor does not exercise its option to have the Lease assigned to it and the Franchisee remains in possession of the Premises, the Franchisee shall make such changes and modifications in the physical appearance and structure of the Premises (including the removal of all signs and other distinctive replica of the F9 System and the Trademark) so that there will be no similarities to the design, physical appearance or structure of other locations of the Franchisor or of locations of other franchisees of the Franchisor using the F9 System, and/or such other changes or modifications as the Franchisor may in its discretion otherwise require. If the Franchisee shall fail to make changes and modifications as required herein, then the Franchisee grants the Franchisor an irrevocable licence to enter the Premises and to make such changes and modifications at the Franchisee's sole cost, which said cost the Franchisee shall pay to the Franchisor forthwith upon demand;

(d) notwithstanding anything otherwise contained above, and without limiting any rights or remedies to which the Franchisor may be entitled as a result of such termination, the Franchisor, without prior notice, may, but shall not be obligated to, enter upon and occupy the Premises and use all or any part of the Premises, Equipment, Leasehold Improvements or other assets located thereon and used in connection with the Business entirely free of charge. Upon any such entry by the Franchisor, the Franchisee shall leave the Premises forthwith and the Franchisor shall not be liable for trespass or any other tort or for any damages arising therefrom. The Franchisor shall have the right to remain in possession and operate the Business for the Option Period and if the Franchisor exercises its options, to have the Lease assigned to it as provided above and to purchase the Property as referred to in clause 13.2, for the period following the Option Period up until the Franchisor completes the purchase (the "Closing Period"). During the Option Period and if such is the case, the Closing Period, the Franchisor shall operate the Business for its own account and it shall be entitled to receive all monies, profits or other benefits from such efforts, and it shall pay all debts or other liabilities which may be incurred during such periods. Further, and notwithstanding the foregoing, the Franchisor shall have the right in its sole discretion to payout of any amounts so received by it, the claims of any creditors of the Franchisee in respect of the Business, and the Franchisee shall be responsible to repay to the Franchisor, immediately upon demand therefor, the amount of any such payments. The Franchisor shall have no obligation to retain any employees of the Franchisee nor honour any other contractual obligations of the Franchisee in respect of the Business. The responsibility for any payments to or for the benefit of any employees so retained by the Franchisor shall arise only upon the Franchisor's commencing to operate the Business, and all obligations (including unpaid salary, vacation pay and other employment benefits) owing to such employees prior thereto or to any employees not so retained shall be the sole responsibility of the Franchisee. The occupation by the Franchisor of the Premises shall not be construed in any way to be an assignment or reassignment or subletting or re-subletting of the Premises and the Franchisor's only responsibility with respect thereto shall be to pay any rent which may be owing once the Franchisor enters and occupies the Premises. All rent and other amounts owing prior thereto shall continue to be the responsibility of the Franchisee.

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Termination by the Regional Franchisor

12.5 If the Franchisee fails to perform any of its obligations under this Agreement the Regional Franchisor may serve a notice of demand setting out the alleged breaches and the action required to be undertaken by the Franchisee to rectify such breach.

12.6 Where the Regional Franchisor has served a notice pursuant to Clause 12.5 above, the Regional Franchisor may terminate this Agreement if at the expiration of twenty-eight (28) days from the date the notice is served, the Franchisee has not totally rectified such breach in

accordance with the notice to the satisfaction of the Regional Franchisor.

Termination without notice

12.7 The Regional Franchisor may terminate this Agreement immediately upon the occurrence of any of the following:

- If the Franchisee commits an act of Bankruptcy within the meaning of the law in the jurisdiction in which the Franchise Business operates,
 - If the Franchisee fails to contest within the requisite time for service, any petition in bankruptcy or application for winding up;
 - if the Franchisee fails to contest or satisfy within fourteen (14) days of service any execution, levy or distress against the assets of the Franchisee;
 - if the Franchisee fails to contest and have removed within fourteen (14) days of appointment, a receiver, and manager or other custodian of the Franchise or any part of the Franchisee's assets;
 - if the Franchisee makes an assignment for the benefit of creditors or makes any composition or arrangement with creditors other than with the consent of the Regional Franchisor;
 - if the Franchisee purports to assign, charge or encumber the Franchise other than pursuant to this Agreement;
 - if the Franchisee operates the Franchise so that the safety or property of any person, including the Franchisee, is in the reasonable opinion of the Regional Franchisor endangered or threatened;
 - if the Franchisee voluntarily abandons the franchise or the franchise relationship resulting in failure to actively conduct the Franchise Business.
 - If trade or other licences required by law have been revoked, cancelled or otherwise suspended.
 - if the Franchisee fails to commence operating the Franchise within twenty-eight (28) days of the execution of this Agreement;
 - If the Franchisee provides any report, financial statement or other material required by this Agreement which is misleading unless the Franchisee demonstrates that this was the result of inadvertent error;
 - if the Franchisee sells or offers for sale any unauthorised goods or unauthorised Services to any client of the Business, such approval not to be unreasonably withheld;
 - if the Franchisee breaches any law, ordinance, rule or regulation in connection with the operation of the Franchise (whether directly or indirectly) and:
 - i) does not refrain from continuing to breach those laws ordinances or regulations, or
 - ii) fails to rectify the breach;
 - within seven (7) days of being notified by the Regional Franchisor or by the responsible authority of that violation;
 - iii) if the Franchisee submits any information or material to the Regional Franchisor before or during the Term which the Regional Franchisor reasonably believes to be untrue or misleading or deceptive;
where the Franchisee is in default of a business loan obtained with the assistance of the Regional Franchisor for the purposes of establishment of the Franchise Business and has failed to rectify that default;
 - if the Franchisee and/or any officers of the Franchisee is convicted of any offence which is reasonably likely to adversely affect the System, or the National Franchisor's Intellectual Property(including any goodwill attached thereto).
 - if the Franchisee or a director, shareholder, principal or partner, as the case may be, breaches any covenant against competition or any covenant against misuse of confidential information;
 - if the Franchisee misuses or permits the misuse of the National Franchisor's Intellectual Property or does any act or permits the doing of any act which harms the goodwill and reputation attached to the Intellectual Property, and the Franchisee fails to remedy the default within twenty four (24) hours of notice from the Franchisors;
- execution of any legal process is levied upon the Franchisee or its property and such legal process is not stayed or satisfied within seven (7) days;
- any person entitled to exercise any form of security over the assets of the Franchisee exercises

such security; or

- if the Franchisee is unable to pay its debts as and when they fall due.
- The Franchisee has received more than six (6) complaints in six (6) months on three (3) separate occasions during the term of this Agreement.
- The Franchisee does not have the required insurance cover as described in Clause 7.55.

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Termination of Territory rights: If the Franchisee declines to take new leads from the Territory for forty days or more in any sixty-day period, unless this is for clearly temporary reasons such as illness or accident, their right of first refusal may be terminated on 28 days' notice. Notice will be withdrawn if the Franchisee offers for sale no less than half their territory for 25% of the Initial Franchise Fee as advertised for a new franchise in the Region.

Conditions of termination of Work Availability Guarantee: Work Availability may be terminated if any of the following conditions apply.

- This Franchisee has refused work outside Territory on at least four days in a week (excluding illness or injury), eight times, or is employing someone at least 20 hours per week.
- In any six month period, the proportion of Client Leads resulting in work done is less than 60% of the Service Success Ratio (Item 9 of the Schedule). In other words, the Franchisee is well below average in converting leads to jobs, which usually reflects poor customer service.
- The territory has been changed, at the request of the Franchisee
- A misleading statement has been made as to clients given free services, unless inadvertently
- (Mowing only), a Franchisee has Regular Clients which, if done once, would earn 1.75 times the Work Availability Guarantee.

Termination by the Franchisor with notice

The Franchisor may serve a notice of demand setting out a breach by the Franchisee of this Agreement, including but not limited to:

- Failing to actively conduct the business.
- Failing to pay money owed, whether to the Franchisor or any other entity
- Lacking the required insurance cover
- Lacking trade or other licences required by law.
- Receiving more than six complaints in six months on three separate occasions

If not rectified within 28 days, the Franchise may be terminated. If before the expiry of this 28 days, the Franchisee agrees to sell the Franchise at a fair market price, the Franchisor will do their best to arrange this rather than terminate. The Franchisor may require that the Franchise is caretaker until a sale can be made, in which case no ongoing fees need be paid.

Termination by the Franchisor without notice

The Franchisor may terminate this Agreement immediately if the Franchisee:

loses financial control of their business (such as through bankruptcy or having a receiver appointed).

is convicted of a criminal offence, or of any breach of law or regulations relating to the business. acts so that, in the reasonable opinion of the Franchisor, the safety or property of any person is endangered (including the Franchisee).

Provides written information that is misleading, unless inadvertently.

Acts in a way that would bring the company into disrepute. Examples include failure to fix client complaints promptly and courteously as directed by the Franchisor, public drunkenness, and repeated incidents of foul language or aggressive behaviour.

Effect of termination

Upon termination the Franchisee must:

- cease to provide Services to Clients, or to any person within twenty km of the Territory for two years. If it continues to provide Services, the Franchisee must pay to the Franchisor the full amount of fees that would be payable had the Contract continued to operate until the date the Franchisee ceases to provide the Services.
- cease to hold itself out as a Franchisee, or display any sign of the trade mark and signage used in the business. This will normally involve a total re-spray of the trailer and/or work vehicle, if retained.
- transfer to the Franchisor any phones or phone numbers used in the Business;
- return all copies of the Manual, proprietary computer programs, etc.
- pay any money owed to business creditors, including the Franchisor
- provide a complete list of Regular Clients (if any)

Option to purchase the assets of the Franchise

Within thirty days of termination, the Franchisor may choose to purchase the trailer and/or equipment for its original purchase price minus 20% per annum depreciation.

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37 Termination

37.1 Special Circumstances – if the Coach:

- (a) No Licence – no longer holds a licence that the Coach must hold to carry on the Business;
- (b) Company Liquidation – being a company:
 - (i) is placed under official management;
 - (ii) enters into an arrangement with its creditors (except for the purposes of reconstruction or amalgamation);
 - (iii) has receivers or receivers and managers appointed to any of its assets; or
 - (iv) is wound up either compulsorily or voluntarily;
- (c) Arrangement or Composition – being a natural person: -
 - (i) commits an act of bankruptcy;
 - (ii) makes an arrangement with his creditors or others;
- (d) Abandons Business – voluntarily abandons the Business or Franchise relationship;
- (e) Serious Offence – is convicted of a serious offence as defined in the Code;
- (f) Endangers Public – operates the Business in a way that endangers public health or safety;
- (g) Fraud – is fraudulent in connection with the operation of the Business; or
- (h) Agreement to Terminate – agrees to the termination of this Agreement, then Franchisor may, in addition to other rights and remedies conferred on it at law or in equity: -
 - (i) sue the Coach for money due and payable under this Agreement; and/or
 - (ii) sue the Coach for damages for breach of contract; and/or
 - (iii) sue the Coach for specific performance of the contract; and/or
 - (iv) terminate this Agreement and sue the Coach for damages for breach of contract in which case its obligations to the Coach will cease at the date of termination;but Franchisor will not exercise its rights under clause 37.1 if this Agreement is terminated under clause 37.1(h).

37.2 Breach – If the Coach breaches a term of this Franchise Agreement, then Franchisor must: -

- (a) give the Coach reasonable notice that Franchisor proposes to terminate this Agreement because of the breach;
- (b) tell the Coach what Franchisor requires to be done to remedy the breach; and
- (c) allow the Coach a reasonable time to remedy the breach;

but if the Coach does not remedy the breach within that time then Franchisor may exercise its rights as set out in Clause 37.1

38 Termination by franchisee

38.1 If Franchisor breaches any of its substantial obligations under this Agreement and fails to remedy the breach after receiving a notice specifying the breach from the Coach, the Coach may by notice terminate this Agreement and this Agreement will be deemed terminated from the date of that notice. Before the Coach can terminate this Agreement the Coach must with clause 37.2 Mutalis Mutandis.

39 Action upon termination

39.1 Action Upon Termination – If this Agreement ends for any reason the Coach must : -

(a) cease to enjoy all rights and privileges granted to it by Franchisor;

...

(g) cease to carry on the business;

(h) not at any future time in any manner or for any purpose directly or indirectly use any of the Intellectual Property, procedures, techniques or materials acquired by the Coach under this Agreement;

(i) not be entitled to any payment for goodwill

...

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11 TERMINATION

11.1 By Franchisee

11.1.1 The Franchisee may terminate by written notice to the Franchisor within 90 days after the earlier of:

11.1.1.1 entering into the agreement; or

11.1.1.2 paying any money under the agreement.

11.1.2 On termination under clause 11.1.1, the Franchisor must repay to the Franchisee all moneys paid under the agreement less the Franchisor's reasonable expenses in respect of:

11.1.2.1 education and training costs;

11.1.2.2 advertising costs;

11.1.2.3 legal costs;

11.1.2.4 employee deployment in respect of the Franchisee; and 11.1.2.5 out of pocket expenses, breaches a material term of this agreement and fails to correct such breach

within 30 days after receiving a dispute notice from the Franchisee describing such breach, sent by security post, the Franchisee may terminate this agreement effective 30 days after delivery by security post to the Franchisor of a written notice of termination with the parties hereby agreeing that the amount to cover the Franchisor's expenses will be a maximum of 25% of the Licence Fee.

11.1.3 This clause does not apply where the Franchisee has purchased the Business or has operated the Business under a previous agreement.

11.2 By Franchisee for Breach

11.2.1 If the Franchisee is in compliance with this agreement and the Franchisor breaches a material term of this agreement and fails to correct such breach within 30 days after receiving a dispute notice from the Franchisee describing such breach, sent by security post, the Franchisee may terminate this agreement effective 30 days after delivery by security post to the Franchisor of a written notice of termination.

11.3 By Franchisor for Breach in Special Circumstances

11.3.1 If the Franchisee:

no longer holds a licence that the Franchisee must hold to carry on the Business; becomes bankrupt or insolvent under administration; voluntarily abandons the Business or the licence relationship; is convicted of a Serious Offence; operates the Business in a way that endangers public health or safety; is fraudulent in connection with the operation of the Business; agrees to termination of this agreement; or does or permits any act that would entitle the Franchisor to terminate this agreement and the licence without providing the Franchisee with a notice to remedy .

THEN the Franchisor may, without providing any notice to remedy to the Franchisee, immediately terminate this agreement and the licence by written notice to the Franchisee. Termination does not affect the Franchisor's existing or other rights.

11.4 By Franchisor for Breach

11.4.1 If:

11.4.1.1 the Franchisor reasonably determines during, or on the completion of any training programme, that the Franchisee or the Nominated Operator has not satisfactorily completed the training programme;

11.4.1.2 there is any breach by the Franchisee of any agreement between the Franchisee and the Franchisor or an associate or related body corporate of the Franchisor;

11.4.1.3 there is any breach by the Franchisee of any agreement which relates to or is concerned with the Business;

11.4.1.4 during a continuous period of three (3) calendar months or more, the Franchisee is not accredited to sell any of the Products or Services;

11.4.1.5 the Franchisee, being a company:

11.4.1.5.1 has a receiver or receiver and manager of any of its assets appointed;

11.4.1.5.2 has a mortgagee or an agent appointed by a mortgagee enter into possession of its assets; or

11.4.1.5.3 commits an act of bankruptcy or has its property seized under any distress or execution;

11.4.1.6 subject to clause 10.5; the Franchisee or the Nominated Operator becomes incapable of or unable or unwilling to conduct or manage the Business or is absent from the Business without the written approval of the Franchisor for any cause for a period in excess of 28 days;

11.4.1.7 subject to clause 10.5, the Franchisee or the Nominated Operator dies or is incapable of satisfactorily performing its obligations under this agreement;

11.4.1.8 the Franchisee makes any material misrepresentations in the course of or relating to the acquisition of the Business or engages in conduct which reflects unfavourably in a material way on the operation of the licence or the reputation of the " " System;

11.4.1.9 the Franchisee or the Nominated Operator is convicted of any criminal offence involving dishonesty or engages in conduct which reflects unfavourable in a material way on the operation of the licence or the reputation of the " " System;

11.4.1.10 the Franchisee damages the name or reputation of the Franchisor, the Franchisor's subsidiaries or the " " System;

11.4.1.11 the Franchisee breaches any other obligation under this agreement;

11.4.1.12 the Franchisee loses its right to occupy the Premises other than as a direct result of any act or omission of the Franchisor which comprises a breach of the Franchisor's lease of the Premises;

11.4.1.13 the Franchisee breaches any of its obligations under any finance arrangement relating to the acquisition of the Business or this agreement; THEN

11.4.2 The Franchisor will:

11.4.2.1 give the Franchisee reasonable notice that the Franchisor proposes to terminate this agreement because of the breach;

11.4.2.2 tell the Franchisee what the Franchisor requires to be done to remedy the breach; and

11.4.2.3 allow the Franchisee a reasonable time to remedy the breach.

F13

S. 11: Termination Before End of the Period:

S. 11.1: Without prejudice to any other remedy F13 may have against you, if any of the events set out in clause 11.2 occur, F13 may terminate this agreement immediately without giving notice to you.

S. 11.2: The events referred to in 11.1 are if you, or one of your directors:

(a) becomes bankrupt, insolvent under administration or an externally administered body corporate;

(b) are convicted of an indictable offence;

(c) are fraudulent in connection with the franchised operation;

(d) voluntarily abandon the franchised operation or the franchised relationship. If you lose the right to occupy the location or otherwise to operate the franchised operation for at least 3 consecutive days without notifying F13, you shall be deemed to have abandoned the franchised operation for the purposes of this clause;

(e) cease to hold any licence, registration or authority required by this agreement;

(f) operate the franchised operation in a way that endangers public health or safety; or

(g) take, or omit to take, any action which is at the time listed in the Code as a ground for immediate termination of a franchise agreement.

S. 11.3: F13 may terminate this agreement where:-

- (a) you have breached a provision of this agreement; and
- (b) F13 has given written notice of:-
 - (i) the breach; and
 - (ii) F13' proposal to terminate the agreement as a result of a breach unless it is rectified within a reasonable period;
 - (iii) the action required by F13 to rectify the breach; and
 - (iv) the reasonable period (not more than 30 days) in which you have to rectify the breach;
- and
- (c) you fail to rectify the breach within the reasonable period.

S. 11.4: If you breach a provision of this agreement on more than two occasions in any 12 month period and you have in each case received written notice of breach under this agreement, the reasonable period of notice required by this agreement and the Code for any subsequent breach of the same or similar provision is 2 business days.

S. 11.5: If F13 determines on reasonable grounds that any breach of this agreement has been deliberate and calculated to cause damage to F13, the parties agree to accept that the reasonable period of notice required under this agreement and the Code is seven (7) days or such shorter period as F13 determines necessary to avoid F13 suffering loss or damage.

S 11.6: F13 may terminate this agreement by written notice effectively immediately if:-

- (a) the breach is incapable of being remedied and F13 has suffered or is likely to suffer substantial loss or damage;
- (b) you act in a manner which would permit immediate termination at law.

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Termination by us

53. If you:

- (a) no longer hold any licence or authority that you may require to carry on the Business or your right to occupy the Business Premises is terminated;
- (b) enter into any form of insolvency administration, such as voluntary administration, receivership, liquidation, bankruptcy or any arrangement under Parts IX or X of the Bankruptcy Act 1966 (Cth);
- (c) voluntarily abandon the Business or the franchise relationship between you and us;
- (d) are convicted of a serious offence (namely, any offence which you would be liable, on first conviction, to imprisonment for a period of not less than 5 years);
- (e) operate the Business in a way that endangers public health or safety;
- (f) are fraudulent in connection with the operation of the Business;
- (g) agree to termination of this Agreement,

we may at our option immediately terminate this Agreement by giving you written notice to that effect.

54 If you breach any other term of this Agreement (being a term not referred to in the preceding clause) and:

(a) we have given you written notice specifying the breach, informing you what you must do to remedy the breach and stating that if you do not remedy the breach within the time specified in the notice we will terminate this Agreement; and

(b) you do not remedy the breach within the time specified in the notice, we may at our option immediately terminate this Agreement by giving you written notice to that effect.

The time to remedy the breach that we will specify in any notice given under subclause (a) will be reasonable, but will not in any event exceed 30 days.

Rights and obligations of the parties on termination

55. Upon termination of this Agreement for any reason whatsoever:

Your obligations

(a) you and the Guarantors must:

(1) Immediately vacate the Business Premises (leaving them in the same condition as that on the date you commenced trading from the Business Premises after allowing for fair wear and tear) and leave all fixtures, fittings, plant and equipment used by you in running the Business in the Business Premises;

(2) Immediately deliver to us all keys to the Business Premises;

(3) Immediately cease using any signs, stationery or other material which may give the public the impression that you remain or are in any way connected with us;

(4) Immediately return to us the original and any copies of the Manual, recipe books, newsletters, or any other written material produced by us;

(5) Immediately cancel the registration of the Business Name;

(6) Immediately cease using our Trademarks and Intellectual Property;

(7) Immediately pay to us all money which you owe us;

(8) Compensate us for the reasonable costs we incur in reinstating the Business Premises to the same condition as that on the date you commenced trading from the Business Premises after allowing for fair wear and tear;

(9) Sell to us such of your fixtures, fittings, plant and equipment used in connection with the Business that are not already owned by us and as we choose if we exercise our option to purchase contained in clause 55(b);

(10) Comply with clause 27 of this Agreement.

F15

11.1 Events of Default and Termination.

11.1 (A) In circumstances where Clause 23 of the Code does not apply the Franchisee shall commit an Event of Default where:

(a) the Franchisee fails to pay any sum of money due under this Agreement by it to the Franchisor within seven (7) days from the due date of payment;

(b) the Franchisee being a natural person becomes of unsound mind or infirm;

(c) the Franchisee or any of the Guarantors shall have its property seized under any distress or execution or makes an arrangement with or assignment for the benefit of its creditors or becomes bankrupt or (being a company) is the subject of any winding up proceedings or makes any arrangements or composition with its creditors;

(d) the Franchisee or any of the Guarantors is convicted of any criminal offence;

(e) the Franchisee (being a corporation) has a receiver or a receiver and manager appointed over the whole or any part of its property or undertaking or has an administrator, official manager or other controller appointed pursuant to the provisions of the Corporations Law or any legislation or companies ordinance dealing with or regulating the incorporation,

operation and affairs of companies in Australia or the state or Territory in which the Franchisee was incorporated;

- (f) the Franchisee being a partnership;
- (i) changes its membership without the prior written approval of the Franchisor; or
- (ii) is terminated or dissolved;
- (g) the Franchisor serves upon the Franchisee pursuant to Sub-Clause 11 .1 (A) (t), two or more written notices for a breach of the covenants and conditions contained in and on the part of the Franchisee to be observed and performed under this Agreement notwithstanding that any breach is capable of being or has been or is being remedied;
- (h) the Franchisee is a corporation and control of the Franchisee by the Shareholders who are Shareholders at the date of this Agreement is passed by them to other persons or corporations without the consent in writing of the Franchisor;
- (i) the Franchisee breaches any other agreement it has entered into with the Franchisor or the terms of the Sub-Lease it has entered into with the Leasing Company or, pursuant to Subclause 12.7(a) (vii), generally fails to pay its debts to the Franchisor, or any suppliers or fails to pay monies payable under the terms of any Sub-Lease as they become due;
- (j) the Franchisee is a party to the doing of any act matter or thing, which is either without the consent of the Franchisor or not allowed by the terms of the Agreement, whereby any of the Intellectual Property used in connection with the System, including but without limitation the Franchised Operation, may be prejudicially affected;
- (k) the Franchisee declares or purports to declare that it holds the Franchise or the Franchised Operation upon trust for another person other than on behalf of a trust approved by the Franchisor, in existence at the date of this Agreement or where the trust is or is not disclosed to the Franchisor and the consent in writing by the Franchisor is not granted to that trust;
- (l) the Franchisee sells any unauthorised products or supplies or uses any unapproved equipment, fittings or fixtures in the operation of the Franchised Operation;
- (m) the Franchisee fails to submit when due, any report required by the Franchisor whether pursuant to this Agreement or otherwise;
- (n) the Franchisee wilfully or fraudulently misrepresents any fact, condition or report required to be made by this Agreement;
- (o) the Franchisee for a reason other than clerical error, understates the Gross Sales for any Accounting Week by more than two percent (2%) or by reason of clerical error or otherwise, understates the Gross Sales for any Accounting Week by more than two percent (2%) on more than two (2) occasions in any twelve (12) month period;
- (p) the Franchisee, without the prior written consent of the Franchisor, obtains or seeks to obtain a licence to operate a business similar to or in competition with the F15 Shop;
- (q) the Franchisee without the prior written consent of the Franchisor, gives any security interest in any equipment, goods or chattels of the Franchised Operation or sells any of such goods or chattels except in the normal course of business, such that the foregoing materially impairs the Franchised Operation or the rights of the Franchisor to acquire them upon the termination or expiration of this Agreement.
- (r) the Franchisee is a company, it grants a charge over its Assets without first obtaining the Franchisor's consent;
- (s) the Franchisee admits in writing its inability to pay debts generally as they become due;
- (t) if and whenever there shall be a breach or non-observance or non-performance of any of the covenants and conditions herein contained on the part of the Franchisee to be observed and performed and such breach continues for fourteen (14) days after service of a notice in writing on the Franchisee requiring it to remedy same providing that the Franchisor advises the Franchisee what the Franchisor requires to be done to remedy the breach;
- (u) if the Franchisee is unable, to the absolute satisfaction of the Franchisor, or unwilling to complete the Initial Training in accordance with this Agreement;
- (v) in the event that the Franchisee acts in the capacity as the trustee of any Trust, upon the occurrence of any of the additional grounds of termination stipulated in Clause 15(e);

(w) if the Franchisee or the Guarantor undertakes any act that prejudices or damages the image of the System or the Franchised Operation.

11.2 (A) Grounds for Termination by Franchisee. The Franchisee may terminate this Agreement if:

- (a) the Franchisee is in substantial compliance with this Agreement; and
- (b) the Franchisor breaches a material term of this Agreement and fails to correct that breach within fourteen (14) days after written notice, sent by security post or courier describing such breach is delivered to it.

F16

Termination requirements are listed in Part 14.

The Franchisor is entitled to **terminate by thirty (30) days notice** if the franchisee (14.1)

- fails to perform any obligation imposed by this agreement
- fails to meet the requirements of the Development Schedule
- attempts or purports to make an assignment
- is not contactable for a continuous period of ten (10) days
- commits a breach
- misuses, makes or allows any authorised use of the Marks or impairs the goodwill associated with the Marks
- engages in any business under a name or mark that is confusingly similar to the Marks
- no longer has the ability to property service sub-franchisees
- has been made three (3) or more unacceptable conduct of a serious nature with a complaint being made
- commits wilful and repeated deception
- has been written notice, three times within any period of three (3) consecutive months in regard to an essential term

The Franchisor is entitled to make an **immediate termination by giving written notice** of termination to the Franchisee, following the occurrence of all or any of the following (14.2)

- Franchisee being convicted of a serious offence that is substantially related to the Business which is reasonably likely to adversely affect the System, the Marks or the goodwill
- Franchisee being convicted of any serious offence that is punishable by a term of imprisonment
- Franchisee ceases to carry on or voluntarily abandons its business or a substantial part
- Franchisee is fraudulent in connection with operation of the Franchised business
- Franchisee no longer holds a licence that the Franchisee must hold to carry on the business
- Franchisee operates the business in a way that endangers public health or safety
- Franchisee agrees to termination of the Franchisee agreement

The Franchise agreement will **immediately terminate** upon the occurrence of any of the following events **without the necessity of a notice** (14.3)

- Franchisee (being a corporation) being in a winding-up
- Franchisee (being an individual) commits an act of bankruptcy
- Franchisee is dissolved
- An appointment of a receiver
- Execution of a final judgment not stayed or satisfied within seven days
- The Regional Master Franchisee is or states that is unable to pay its debts when they fall due

14.4 If the Franchise has been given written notice by the Franchisor under 14.1 three times within any period of three (3) consecutive months and in each of such case the Franchisee has complied with the notice and duly remedied the default, then, upon the happening of any event specified in Part 14.1 within a three (3) month period commencing upon the date upon which the last of the said notice was complied with, the Franchisor may by thirty (3) days written notice to the Master Franchisee terminate this and any related agreement and the Sub-licence forthwith.

14.6 Effect of termination: Upon surrender, termination or expiration of this agreement, the Franchisee shall immediately cease to operate as the Franchisee, and the Franchisee shall have no right to licence any person to establish or operate any Franchise area for which a Franchise Agreement has not been executed by the Franchisee at the time of termination.

14.7 Legal Costs: In the event of any default by the Franchisee whether or not such default gives rise to termination of this agreement, the Franchisor shall be entitled to recover from the Franchisee reasonable legal fees, costs and expenses on a solicitor and client basis incurred by the Franchisor as a result of such default.

14.10.1 Option to Purchase: Upon expiration or termination of this agreement, the Franchisor may by written notice to the Franchisee, elect to purchase free from encumbrances any or all of the assets of the Business.

F17

26.7 It is a default, even if it is not in your or your associates' control if: you or your associates:

- repudiate this agreement or any of the transaction documents;
- breach an essential or fundamental term of this agreement or the transaction documents;
- you or one or more of your associates or guarantors do not comply with this agreement, the transaction documents or any other agreement with us after having received reasonable notice in writing to remedy a default. We consider 14 days to be reasonable notice. We do not have to in any case allow more than 30 days reasonable notice to remedy a default;
- you and/or your associates have in connection with your application for your franchise made any false or misleading misrepresentation to us or our associates with respect to a material particular;
- you undertake a dealing eg the sale of your business restricted by this agreement without our consent and in a manner not permitted by this agreement;
- without reasonable cause, you do not open and start running your business after 14 days written notice from us to start your business so long as the notice is not given before the start date;
- for more than 30 days, you do not, without reasonable cause, give us any reports that you are required to give by this agreement after a written request by us for the relevant reports or documents;
- you or your associates knowingly maintain false accounts and/or give to us reports that are false with respect to a material particular;
- you or any of your associates:
- hide sales or understate or falsify your turnover by more than 3% in any week during the franchise term, unless you or your associates prove to us that the understatement was due to an honest but
- inadvertent error by you, your associates or your employees;
- make or allow unauthorised disclosures or use of the manuals or the confidential information;
- attachment, distress, execution, order, final judgment or other process of the crown, authorities or courts, is issued against, levied or enforced for \$10,000 inclusive of GST or

more against you, your business or your assets and is not set aside or satisfied within 30 days or more (unless an application, appeal or proceedings (proceedings) within that period have been started or made in good faith with a court or other body of appropriate jurisdiction to stay, set aside or appeal the relevant execution, judgment or other process and so long as the relevant proceedings are pursued diligently by or for you and so long as we are kept reasonably informed of the progress and outcome of the relevant proceedings and so long as we are given if we require and to no cost to us, copies of all relevant proceedings and supporting affidavits, documents, correspondence and material filed or used in those proceedings and so long as we are paid our reasonable legal costs in connection with those matters);

- you give or allow to exist encumbrances (except permitted encumbrances) over this agreement, your store premises agreement, you, your business or your assets;
- an insolvency happens to you or any guarantor except that in the case of the insolvency of a guarantor 30 days will be allowed for appropriate and reasonable arrangements to be made with us or our associates for the provision of a new or substitute guarantor reasonably suitable to us and our associates and for the signing and completion by that new or substitute guarantor of a guarantee and indemnity or other sufficient security satisfactory to us or our associates to secure the relevant obligations that are or were being secured by the guarantor to which the insolvency happened:
- without our consent, which consent will not be unreasonably refused:
- you stop being a subsidiary or a company stops being your subsidiary; you or a guarantor that is a company reduces its share capital;
- a resolution is passed that makes your uncalled share capital unable to be called up except in your winding up;
- there is a change in the ownership or control of you or your associates (as either a director, shareholder, unit holder or in the case of a trust, the trustee or the appointor) which leads to an effective change in the ownership or control of you or your associates:
- a notice deregistering you or a guarantor is given under the Corporations Law and is not withdrawn or remedied within 30 days of getting it (unless an application or proceedings (proceedings) within that period have been started or made in good faith with a court or other body having appropriate jurisdiction for the reinstatement of the relevant company and so long as those proceedings are pursued diligently by persons having the necessary interest and so long as we are kept reasonably informed of the progress and outcome of the relevant proceedings and given as we require at no cost to us, copies of all relevant proceedings and supporting affidavits, documents, correspondence and material filed or used in those proceedings and so long as we are paid our reasonable legal costs in connection with those matters):
- without our consent, a receiver, controller or administrator (as defined in the Corporations Law) is appointed or a secured creditor takes possession of you, your business, or a substantial, significant or material part of your assets or the assets of a guarantor;
- you abandon or vacate the store or your business for more than 7 continuous days or you stop or suspend the operation of your business for more than 7 continuous days except due to a force majeure or except in a way allowed by this agreement or except on public holidays when your business is not required to be open and trading;
- you allow your debts and accounts with your creditors to be overdue for more than 60 days (unless the relevant debt or account is the subject of a genuine dispute made in good faith and so long as reasonable action is taken to resolve or have the dispute decided by a court or other body of appropriate jurisdiction by the parties to the dispute and so long as we are kept reasonably informed of the progress and outcome of the relevant dispute or of any proceedings taken to have the matter decided by a court or other body and so long as if we ask, we are
- given at no cost to us, copies of all relevant proceedings and supporting affidavits, documents, correspondence and material relevant to the dispute or the proceedings and so long as we are paid our reasonable legal costs in connection with those matters;

- you breach a relevant or material law that affects you, your business or your employees and do not remedy the breach within 30 days after written notice from us, the crown, any authority or anyone else to do so;
- you or any of your key associates commit a criminal offence the subject of a final conviction which conviction has not been overturned or stayed pending an appeal and that offence is punishable by a term of imprisonment for more than 1 year and the offence involves serious dishonesty or moral turpitude in connection with your business or the dealings of you or your associates;
- one of your key associates or guarantors dies or is unable to run your business for any reason including because of severe or serious physical or mental disability and your business or the ownership interest of your key associates is not sold or dealt with under Part 35 (Death or disability);
- you do not sign and return your store premises agreement and any documents in connection with it within 30 days after they are received by you or your lawyers for signing by you:
- any superior store premises agreement expires or ends and as a result your store premises agreement expires or ends or for any other reason you lose your right to possession, use or occupation of the store and a further right to possession, use or occupation of the store cannot be reasonably obtained by or for you and you do not move your business to a new location within 2 km radius from the centre of the store approved by us or our associates, which consent will not be unreasonably refused.

26.10 Ending of your franchise by you

During the franchise term, you cannot end this agreement without our consent nor can you suspend payments of franchise fees or marketing levies, except if:

- we go into official liquidation for more than 3 months (but not in the case of voluntary administration, deed of company arrangement, any court approved scheme of company arrangement or receivership)
- we have not remedied a breach of an essential term of this agreement after 90 days written notice to us from you to remedy that breach so long as the notice to remedy sets out full and reasonable details of the grounds and details of the breach and the action required by us to remedy the breach.

PART 27 EFFECT OF YOUR FRANCHISE EXPIRING OR ENDING

27.1 Payments

If this agreement expires or ends, you must pay within 14 days in the following order, all money owing to:

- us and our associates in connection with this agreement and the transaction documents;
- your unpaid creditors to whom payment has been guaranteed or secured by us or our associates;
- your unpaid creditors in the way or order we tell you to.

27.2 Other obligations

if this agreement expires or ends for any reason, you and your associates must, if we require by written notice to you and/or your associates, in connection with you, your business or the store do the following:

- suspend, wind down and end if and in the way we tell you or your associates the:
- use and display of your business name, trade names, trade marks, F17 intellectual property including all such names, marks or items that are displayed on the store, fixtures, furniture,

chattels, signs or anything else used in connection with your business, the store, or vehicles used by you, your associates, your employees or contractors;

- running of your business under the trade name, the system and the image;
- use of the distinctive, characteristic or identifying features of the system, the image or a F17 store;
- use of any F17 food and beverage menus, marketing materials, uniforms, clothing, dress and name tags used by you, your associates or your employees;
- within 14 days return and deliver to us:
 - translated, authorised and unauthorised copies of all manuals in the control of you, your associates or your employees;
 - unused F17 food and beverage menus, serviettes, food or beverage brochures, forms, stationery (including weekly or monthly reports), business cards, letterheads, printed material, ticketing, F17 name tags, posters, packaging and carry bags and other items used in connection with your business or the store which display or contain the trade names, trade marks or that relate to the system or the image;
 - all current and old stock of F17 food and beverage menus;
 - unused stock control lists, vouchers, promotional leaflets, advertising and catalogue material and order books that display the trade names or trade marks or that relate to the system or the image;
 - all marketing materials, signs, banners and umbrellas that relate to the system, the image, the trade names or the trade marks;
 - all copies of all licenced software and databases kept by or for you and make sure that you deliver at least 1 uncorrupted and working copy of each of them;
 - all lists and records of names, addresses and other details of your customers and all application forms, records and databases connected to F17 VIP club members or customers:
 - within 14 days give us a report detailing your turnover to the last day of trading or such other date we reasonably state;
 - if we ask, you must sell us all your unused and remaining stock of paper goods, ticketing, posters, menus, promotional material and all other items containing the trade name or the trade marks at the lower of their cost or net realisable value;
 - cancel or transfer (as we require) all registrations in the name of you or your associates of the trade names, the trade marks or the phone services;
 - make sure that your registration as an owner or user of any trade name, business name or trade mark is removed from all Commonwealth, State or local, city or government registers anywhere in Australia;
 - fill in, sign and register with the ASIC or any other register or person we reasonably require documents needed to change your company and your business name to leave out the trade names or trade marks;
 - within 30 days to our reasonable satisfaction:
 - de-image and de-identify the store and make changes to the layout, appearance, get-up and decor to the inside or outside of the store, fixtures, furniture, chattels and signs, including the removal of signs connected with a F17 store so that all those items are all clearly and substantially different from the same or similar items that are or were used in the store or other F17 stores or that are part of the system or the image;
 - take down and remove from the inside and outside of the store, fixtures, furniture, chattels, signs connected with the store, the trade names, trade marks, the decor or other items that incorporate any distinctive characteristics or identifying features of a F17 store or that are part of the system or the image;

- make any changes to the designs, layout, appearance, get-up and decor of the store we require to clearly and effectively distinguish the store from the image used by any other F17 store in Australia:
- within 30 days to our reasonable satisfaction alter, change or take down as we require:
- any distinctive, characteristic or identifying lighting or signage used in connection with the store and that are or can be connected with a F17 store;
- the paintings, prints, posters, logos that are or have been used in your business or that relate to the system or the image;
- the service counter, furniture, tables and chairs used in the store and replace them with substantially different materials;
- vacate the store and remove from the store the personal belongings of your associates or the guarantors which do not form part of your assets;

27.3 If this agreement expires or ends for any reason, you and your associates must not try to claim that the benefit of any store premises agreements held by us or our associates, are held under any express or constructive trust for the benefit of you, your associates or anyone else.

27.4 Our rights

If this agreement expires or ends, we or our associates may at any time enter the store, without being liable for trespass, civil wrongs or a breach of other laws, to make sure you and your associates have complied with this agreement and the transaction documents and to make sure that changes to the store, fixtures, furniture, chattels, signs and other assets that are required to be made under this agreement have been or will be properly made.

27.5 If for any reason this agreement expires or ends (and your franchise is not renewed or renewable). we or our associates may develop, open or own another F17 store or allow anyone else to develop open or own another F17 store near the current or any former site of the store or anywhere in the protected franchised area or the right of first refusal area, irrespective of any rights that have previously been given to you or your associates, even if those other F17 stores compete with you, your business, your former business or anyone else including any business run at any current or former site used by your former business.

27.6 Acknowledgments

You and your associates agree that after this agreement expires or ends:

- "despite billing or other arrangements with any of the phone companies and despite you or your associates being a subscriber or user of the phone services, we or our nominee can take over and get a transfer of the phone services so that we or our nominee are or become the sole subscriber or user of those phone services; we may tell the phone companies how to direct or deal with calls to the phone services;
- you and your associates must when we ask do everything and sign and give us all documents we or the phone companies may require to transfer to us or our nominee the phone services that are or have been used by you or your associates in connection with your business;
- if we ask, you and your associates must suspend or end the use of the phone services in connection with your business;
- if we ask, by 14 days written notice to you, you will do everything to make sure that for at least 2 years that:
- calls and faxes to the phone services are redirected or diverted at our cost and in the manner we require;
- a recorded message is placed on the phone services which informs the caller to call us or any other F17 store operator we may state.

27.7 We may require transfer of your store premises agreement

If we ask in writing, you must on or after a default that entitles us to end this agreement, the expiry, end, surrender or non-renewal of this agreement for any reason and without requiring any money, compensation or premium do everything needed to fill in, sign and register all agreements or documents needed to transfer to us or our nominee your store premises agreements as soon as reasonably possible after our request for a transfer. You must use your best efforts to get the consents of all relevant lessors and mortgagees to the transfer of your store premises agreements to us or our nominee.

27.8 Acknowledgments

To the extent allowed by law, you and your associates agree that on the expiry, end, surrender or non-renewal of this agreement or any of the transaction documents for any reason:

- neither you nor your associates will get money or compensation from us or our associates for goodwill or benefits connected with the system, the trade names, the trade marks or your business name;
- any goodwill or benefits connected with the system, the trade names or the trade marks belong or revert to the relevant superior owner of the relevant part of the system, the trade names or the trade marks;
- you and your associates waive and release all your and your associates' rights at law for compensation, indemnity, losses because this agreement or any of transaction documents expires, ends or is not renewed except for fraud or negligence by us.

F18

2.3 The Franchise shall be subject to the following qualifications and restrictions

...(f) If F18 decides for whatever reason that it no longer wishes to continue with the franchise arrangements for the whole of the Network in the format contemplated by this Agreement (as opposed to not wishing to continue with the franchise agreements for the Franchise Owner or a small group of Franchise Owners), F18 will be entitled to terminate this Agreement by giving six months notice in writing to the Franchise Owner, but conditions in (i) and (ii) applies.

2.5 F18 shall be entitled to refuse to grant the Franchise, or to terminate the Franchise if it has already been granted, by written notice effective immediately, if there has been any failure to comply with any of the foregoing pre-conditions.

15 Termination

15.1 F18 may terminate the Franchise by written notice effective immediately if either the Franchise Owner or any of the Principals:

- (a) has any bankruptcy or other trustee, provisional liquidator, liquidator, administrator, receiver, receiver-manager, mortgagee, mortgagee's agent or other insolvency administrator or third party appointed over any assets or enters into any assignment, arrangement or composition concerning any creditors;
- (b) is, or any Nominated Representative, director, officer, employee or agent of the Franchise Owner is, convicted of a criminal offence carrying a gaol term of six (6) months or more, or an offence involving fraud, deception, dishonesty or misleading conduct;

- (c) has any licence, accreditation or authority required by this Agreement cancelled, revoked, suspended or allowed to lapse;
- (d) breaches any provision of this Agreement and, where the breach is capable of being remedied, fails to remedy the breach within thirty (30) days after F18 has given written notice of the breach to the Franchise Owner;
- (e) commits any breach of any of the Collateral Agreements which would entitle the relevant company within the F18 Group to terminate the agreement and, where the breach is capable of being remedied, fails to remedy the breach within the time period allowed by such agreement, or if any of the Collateral Agreements involving the Franchise Owner or the Nominated Representative is terminated;
- (f) acts in a manner which requires F18 or any company within the F18 Group, pursuant to any law, regulation, or code of conduct or any instruction, direction, requirement or request made by any statutory, governmental, industry or regulatory body, to revoke any authority or licence to operate the Franchised Business or any other business activities granted to the Franchise Owner or any of its directors, officers, employees or agents, to sell or supply any of the Approved Products or the Approved Services, or to take any other disciplinary action against them;
- (g) is required, or any of its directors, officers, employees or agents who are engaged in the selling of insurance or financial services products are required by any law, regulation, code of conduct or any instruction, direction, requirement or request made by any statutory, governmental, industry or regulatory body, to hold an authority or licence from a company within the F18 Group, and that company is prohibited by such law, regulation, code of conduct, standard or requirement to issue or to renew an authority or licence to any of such persons;
- (h) fails, or any of its directors, officers, employees or agents fails to comply with any law, regulation, or code of conduct or any instruction, direction, requirement or request made by any statutory, governmental, industry or regulatory body, or fails to act in accordance with F18's specified standards of ethics and business practice;
- (i) breaches any provision of this Agreement or any of the Collateral Agreements where the Franchise Owner has within the previous two years received two or more prior notices of breach and had been given the opportunity to remedy the breaches; or
- (j) fails to achieve the Minimum Performance Criteria for any six month period, and fails to rectify the failure during the subsequent period of six months.

15.2 F18 shall be entitled by written notice to the Franchise Owner to immediately suspend the Franchise Owner and the Nominated Representative from carrying on the Franchised Business pending rectification of any breach where the Franchise Owner has been served with a notice of default pursuant to clause 15.1 (d) or referred to in clause 15.1 (e) and F18 believes that there is a risk that the Franchise Owner may prejudice the goodwill or reputation of the F18 System, the F18 Image or F18 or will not adhere to the F18 Standards during the period, or where the best interests of the Clients of the Franchise Owner make such action desirable.

15.3 F18 shall be entitled by written notice effective immediately, in lieu of terminating the Franchise, to terminate the Franchise in respect of certain of the Approved Products and/or the Approved Services. The relevant company within the F18 Group shall then be entitled to terminate or vary the particular Distribution Agreement with the Franchise Owner and/or the Nominated Representative relating to such Approved Products and/or Approved Services.

15.4 Whenever F18 is entitled to terminate the Franchise pursuant to Clause 15.1 (d), it may elect to accept compensation for the breach in lieu of termination, but F18 shall have the sole

and absolute discretion in determining whether or not to accept compensation, and in determining the amount of such compensation.

15.5 In addition, as stated in clause 2.3(f) of this Agreement, if F18 decides for whatever reason that it no longer wishes to continue with the Franchise arrangements for the whole of the Network in the format contemplated by this Agreement (as opposed to not wishing to continue with the franchise agreements for the Franchise Owner or a smaller group of Franchise Owners) F18 will be entitled to terminate the Franchise by giving six months notice in writing to the Franchise Owner, but [subject to conditions stipulated by (a) to (d)]

15.6 A Franchise Owner may terminate this Agreement by giving to F18 six months prior notice in writing. Upon such termination the provisions of clauses 16 and 18 of this Agreement shall apply.

15.7 If the Franchise Owner is Branded and elects to terminate this Agreement under clause 15.6 then on termination the Franchise Owner must pay to F18 an amount which bears the same proportion to the cost to F18 of the Branding as the length of the time from the date of termination of this Agreement until the end of the Term bears to the Term of this Agreement.

16 Consequences of Termination

16.1 Where the Franchise expires or is terminated for any reason or by any event:-

(a) the Franchise Owner and the Nominated Representative shall immediately upon termination or expiration of the Franchise or earlier sale of the Income Stream cease to operate the Franchised Business, cease to use the F18 Image, the F18 System, the Marks and Intellectual Property, and thereafter not directly or indirectly represent to the public or hold itself out as a Franchise Owner or representative of F18 or as being in any way associated with F18.

(b) the Franchise Owner and the Nominated Representative shall immediately upon termination or expiration of the Franchise or earlier sale of the Income Stream return to F18 all copies of the Manual, any computer software or hardware belonging to F18, any customer listings or other Confidential Information, all stationery, brochures, publications and other materials, and any other items belonging to any company within the F18 Group.

(c) F18 shall not be obliged to provide any support, services or benefits to the Franchise Owner as part of the Franchise. F18 shall however continue to provide the Franchise Owner with all usual product and commission information in relation to the Designated Contracts, and will not jeopardise the Franchise Owner's interest in the Designated Contracts and ability to service the Clients.

(d) F18 shall be entitled to cease to pay, and to notify other companies within the F18 Group to cease to pay, any commission, allowance or entitlement to the Franchise Owner or Nominated Representative as from the earlier of the settlement date for any sale to a third party pursuant to clauses 17, 18 and 19, the signing of a contract of sale with F18 pursuant to clause 17, 18 and 19, or the expiration of two years from the date of termination of the Franchise.

16.2 F18 shall continue after termination to fulfil its obligations under all of the Designated Contracts. If the Franchise Owner is not serving the Clients, F18 may service them and shall be entitled to retain from any commission allowances or other entitlements due to the Franchise Owner or the Nominated Representative any moneys owing to F18 including any unrecovered transitional allowance as described in Schedule F of the Distribution Agreement and any advances of commission allowances or entitlements together with a reasonable fee to cover the costs of servicing the Clients.

16.3 Subject to 16.4, the Franchise Owner shall on termination be entitled to sell all or part of the Income Stream pertaining to the Franchise Owner's Designated Contracts strictly on the conditions and terms set out in clause 17.1 of this Agreement.

16.4 The Franchise Owner shall on giving F18 six months written notice of its intention to terminate this Agreement in accordance with clause 15.6 be entitled to sell all or part of the Income Stream pertaining to the Franchise Owner's Designated Contracts strictly on the conditions and terms set out in clause 18.1 of this Agreement.

16.5 Unless the Franchise Owner is legally unable to continue to Service the Client pending sale of the Income Stream or final termination of this Agreement the Franchise Owner may continue to do so.

16.6 The Franchise Owner or the Nominated Representative shall be entitled, subject to the provisions of this Agreement, to continue to exclusively receive commissions in relation to the contracts which were Designated Contracts of the Franchise Owner or the Nominated Representative as at the date of termination for a period of two years from the date of termination.

16.7 Where F18 has to provide services to the Designated Contracts of the Franchise Owner due to the failure or inability of the Franchise Owner to do so, F18 shall be entitled to retain from any commission, allowances or other entitlements due to the Franchise Owner or the Nominated Representative a reasonable fee to cover the costs of dealing with the Designated Contracts direct.

16.8 Where in any circumstances F18 or any other Franchise Owner buys the Income Stream from the Franchise Owner the Franchise Owner covenants with F18 or such other Franchise Owner as a condition of such acquisition and as an agreed reasonable requirement to protect the goodwill in such Income Stream that the Franchise Owner, the Nominated Representative and all directors or shareholders of the Franchise Owner will not sell any insurance or financial product or service to any of the Franchise Owner's past or current Designated Contracts for a period of two years from the date of acquisition by F18 or any third party purchaser. It shall be a pre-condition of any sale contract that such a covenant be included.

F19

15. TERMINATION RIGHTS

(a) Either party may terminate this agreement by giving notice in writing to the other party if the other party breaches a term of this agreement and, if the breach is capable of being remedied, fails to remedy the breach within thirty days of receiving notice from the other party requiring them to remedy the breach.

(b) The Company may terminate this agreement without cause by giving at least 6 months notice in writing to the Member.

(c) The Company may, by giving notice to the Member, immediately terminate this agreement and all other agreements and arrangements between the Company and the Member:

(1) if the Member no longer holds a registration or approval (whether temporarily or permanently) that the Member must hold to carry on the Business, including for example:

- (i) registration as a pharmacist under the Pharmacists Act;
- (ii) approval of the Location by the Pharmacy Board under the Pharmacists Act;

(2) if the Member becomes bankrupt, insolvent under administration or an externally-administered body corporate;

(3) if the Member voluntarily abandons the Location, the Business or the relationship under this agreement;

(4) if the Member is convicted of a "serious offence" as defined in the *Code*;

(5) if the Member operates the Business in a way that endangers public health or safety;

- (6) if the Member is fraudulent in connection with the operation of the Business;
- (7) in the following circumstances to which the Member has agreed:
 - (i) if, in relation to the Member, an order is made for its winding up, a receiver, receiver and manager, official manager, trustee, administrator or similar official is appointed over any of its assets or undertaking, a provisional liquidator or liquidator or official manager is appointed, it is or is deemed by law to be unable to pay its debts, it becomes bankrupt or it makes any arrangement, compromise with its creditors or members or with any class of its creditors or members, it is dissolved or otherwise ceases to exist, it becomes incapable of performing its obligations under this agreement, or a principal is involved in anything that may damage the good name of the Retail Brand (including without limitation any criminal offence or unethical behaviour).
 - (ii) the Company serves 3 or more notices on the Member for breach of the same term of this agreement over any 12 month period, regardless of whether the Member rectifies each breach;
 - (iii) the Member breaches any conditions to which the approval of the Location under the *Pharmacists Act* is subject;
 - (iv) if the Member ceases to be a pharmacist for any reason or is suspended from practising as a pharmacist for any reason;
 - (v) if a mortgagee or its agent takes possession of all or part of the Member's assets or undertaking;
 - (vi) if the lease over the Location is terminated or possession of the Location is lost due to the act or default of the Member;
 - (vii) if the Member or its manager fails to operate or is absent from the Business for more than 2 weeks, without the Company's prior consent;
 - (viii) if the Member makes any material misrepresentations relating to the entering into of this agreement;
 - (ix) the Member:

(a) on 2 or more occasions, fails to honour cheques presented for payment; or

(b) on 4 or more occasions during any 12 month period, fails to pay any amount payable under this agreement when due (whether or not a formal demand is made);

- (x) the Member uses the Trade Marks other than as permitted under this Agreement;
- (xi) the Member fails to adopt and/or departs from the Program Guidelines;
- (xii) the Member fails to obtain the Company's consent when required; or
- (xiii) if permitted under any other provisions of the Code; or
- (xiv) if the Member acts in a manner which the Company, in its discretion, considers likely to bring the Company or the Retail Brand into disrepute.

(d) A Member who is not a Healthy Member may terminate this agreement without cause by giving at least 6 months notice in writing to the Company.

16. EFFECT OF TERMINATION

(a) Upon termination or expiration of this agreement, the Member will not be entitled to any payment from the Company in respect of the termination including without limitation any payment for goodwill and regardless of the length of the Term.

(b) Upon the termination of this agreement, the Member must:

(1) cease carrying on business under the name and style of the Retail Brand including without limitation ceasing to use the Business Name, the Trade Marks and any other Retail Brand identifiers;

(2) take immediate steps to cancel the registration of the Business Name, and change the name, style and identification of the premises where the Business is conducted and remove and

destroy all distinctive signs, colour schemes and other features associated with the Retail Brand so that the premises no longer resemble or are identified as the Retail Brand; and

(3) return to the Company the Program Guidelines and any manuals, point of sale, promotional, or other materials provided by the Company to the Member including without limitation pelmets and soffits, Retail Brand signage for soffits and gondola caps, information systems Retail Brand prescription signage, external signage, internal hanging department signs, A-frame signs, uniforms and stationery, provided that the Company shall reimburse to the Member the cost of such materials, less a depreciation at a rate advised by the Company from time to time and any appropriate deductions for loss, damage, wear and tear.

(c) In consideration of the right to use the word(s) of the Retail Brand in the Business Name, the Member hereby irrevocably appoints each director and secretary of the Company severally its attorney authorised upon termination of this agreement to sign whatever documents are necessary for the sole purpose of cancelling the registration of the Business Name if the Member fails to take immediate steps to cancel the registration.

(d) If the Member fails to comply with its obligations under clause 16(b) within 30 days of the date of termination, the Member hereby authorises a representative or agent of the Company to enter the premises where the Business is being conducted to remove the Retail Brand identifiers and signs and materials referred to in that clause at the expense of the Member.

APPENDIX D

CONTRACT TERM: RESTRICTIVE COVENANTS

F1

- 15.3 The Franchisee further covenants that, except as otherwise approved in writing by Franchisor, the Franchisee shall not, for a continuous and uninterrupted period, commencing upon the termination or expiration of this Agreement and continuing for two (2) years thereafter, either directly or indirectly, for Itself, or through, on behalf of, or in conjunction with any person, persons, partnership or corporation, own, maintain, operate, engage in, or have any Interest in any business which is the same as similar to the Store and which is located at the Premises or in the building or group of buildings in which the Premises are located or within a circle having a radius of one kilometer and its centre at the Premises.

Sections 15.2 and 15.3 shall not apply to ownership by the Franchisee as a passive Investor of less than a one percent (1%) beneficial interest in the outstanding equity securities of any publicly-held corporation listed on a national stock exchange.

Each of the foregoing covenants shall be construed as, independent of any other covenant or provision of this Agreement. If all or any portion of a covenants in this Section 15 is held unreasonable or unenforceable by a court or agency of competent jurisdiction in an unappealed final decision to which either Baskin- Robbins or the Sub-Franchisor is a party, the Franchisee expressly agrees to be bound by any lesser covenant subsumed within the terms of such covenant that imposes the maximum duty permitted by law, as if the resulting covenant were separately stated in and made a part of this Section 15.

Franchisor shall have the right to reduce the scope of any covenant set forth in Sections 15.2 and 15.3, or any portion thereof, without Franchisee's consent, effective Immediately upon receipt by Franchisee of written notice thereof; and Franchisee shall comply with any covenant as so modified.

F2

The Franchisor must ensure that neither it nor any of its other franchisees establish or operate another business in the nature of the Business at any location in the Territory. (no post termination covenants???)

24. RESTRAINT OF TRADE

- 24.1 Definitions.
In this clause:

(a) “restraint period” means all of any of:

the Term of this Franchise;

- (i) 1 year after a relevant event;
- (ii) 2 years after a relevant event;

- (iii) 3 years after a relevant event;
- (b) “relevant event” means all or any of:
 - (i) the settlement date of the sale by the Franchisee of the Business;
 - (ii) the date this Agreement expires or ends;
- (c) “relevant capacity” means as:
 - (i) sole trader;
 - (ii) partner;
 - (iii) director or shareholder;
 - (iv) manager;
 - (v) employee;
 - (vi) trustee, beneficiary or unit holder of a trust;
 - (vii) consultant;
 - (viii) lender or Security provider;
 - (ix) franchisor or franchisee;
 - (x) landlord;
- (d) “restraint area” means all or any of:
 - (i) the Territory;
 - (ii) the master franchised territory of any of the master franchisees in Australia;
 - (iii) the area within a 5 kilometre radius of any franchisor system business in which either the Franchisor or any other F2 Franchisee operates;
 - (iv) the State or Territory of Australia in which the Territory is located;
 - (v) the State or Territory of Australia in which a master franchised territory of any of the other master franchisees or Franchisees in Australia is located;
- (e) “relevant interest” means all or any of:
 - (i) a legal or beneficial interest;
 - (ii) a financial interest;
 - (iii) a proprietary interest;
- (f) “relevant person” means all or any of:
 - (i) the Franchisee;
 - (ii) any one or more Authorised Representatives;
 - (iii) a shareholder of the Franchisee;
 - (iv) a guarantor of the Franchisee;
 - (v) a relative of the Franchisee;
- (g) “relevant business” means all or any of:
 - (i) a business that is the same or substantially the same as the Business or the former business as conducted by the Franchisee under this Agreement;
 - (ii) an ice creamery business the same or substantially the same as the Business conducted by a Franchisee (whether operated under Franchise or not);
- (h) “relevant goods” means all or any:
 - (i) goods that are the same or substantially the same as those goods that were actually supplied by the Franchisee for use in the Business;
 - (ii) Franchisor system Products, Base Mix and Frost Tops;
- (i) “relevant services” means all or any services that are the same or substantially the same kind as those services that were actually supplied by the Franchisee in connection with the Business;

24.2 Trade restrictions.

The Franchisee and the Guarantor and any relevant person must not without the Franchisor’s consent:

- (a) own or have a relevant interest, in a relevant capacity, in a relevant business, in a restraint area during a restraint period;
- (b) carry on or be engaged in a relevant capacity, in a relevant business, in a restraint area during a restraint period;

- (c) be employed, concerned or interested in a relevant capacity, in a relevant business, in a restraint area during a restraint period;
- (d) lend money, provide financial assistance to or act as security provider to a relevant person to allow a relevant person to:
 - (i) own or have a relevant interest in a relevant capacity, in a relevant business, in a restraint area during a restraint period;
 - (ii) carry on or be engaged in a relevant capacity, in a relevant business, in a restraint area during a restraint period.

24.3 Copyright.

The Franchisee and any relevant person must not in a relevant capacity, in a relevant business, in a restraint area and during a restraint period use, allow any one else to use, copy or sell or deal with:

- (a) the Franchise System or the Corporate Image;
- (b) the distinctive or identifying get up used to identify a Franchisor Ice Creamery delivery van;
- (c) the Intellectual Property;
- (d) the trade names or trade marks;
- (e) the Confidential Information or the know how;
- (f) the Confidential Information about the Commercial Customers;
- (g) the Manuals or the confidential or proprietary information contained in the Manuals;
- (h) marketing materials or copyrighted works prepared or sponsored by the Franchisor that are used to market the supply of goods or services by the Franchisee to Commercial Customers;
- (i) the Products;
- (j) special or proprietary methods that are owned or developed by the Franchisor that may be used to make, handle, store, sell, deliver or use the Products;
- (k) any uniforms, footwear, protective clothing or equipment that display the trade names or trade marks; and
- (l) the Software, any databases or the information kept or obtained from or on them.

24.4 Separate restrictions.

The Franchisee and any relevant person separately agree with the Franchisor to enter into each of the restrictions resulting from combining separately each relevant capacity, with each relevant business with each restraint area with each restraint period. Each of these restrictions is an independent and separate restraint imposed upon the Franchisee and any relevant person under this Agreement. If any restriction in this clause is or will be unenforceable that does not affect the validity or enforceability of other restrictions under this Agreement, which remain binding on the Franchisee and any relevant person.

24.5 Confidential Information.

The Franchisee and any relevant person must during each restraint period after the date of settlement of the sale of the Business or the date this Agreement expires or ends keep secret and confidential and not publish, disclose nor use or attempt to use the Confidential Information or know how.

24.6 Solicitation of a relevant franchisee.

The Franchisee and any relevant person must not solicit, canvass, entice or try to solicit, canvass or entice a franchisee, in a restraint area and for a restraint period with the purpose of offering to supply or supplying that franchisee with either or both relevant goods or relevant services.

24.7 Solicitation of employees.

The Franchisee and any relevant person must not during a restraint period entice or attempt to entice any employee of the Franchisor from continuing to be employed by it.

24.8 No aiding and abetting others to breach restrictions.

Neither the Franchisee nor any relevant person must knowingly counsel, procure, aid or abet the Franchisee or any relevant person to breach or to help the Franchisee or any relevant person breach any of the restrictions in this clause.

24.9 Person who may enforce the restrictions.

The Franchisee and any relevant person agree that the restrictions in this clause are given for the benefit of the Franchisor and Franchisees that own or operate a Franchisor Ice Creamery business in Australia. As the Franchisor is a party to this Agreement, it may enforce these restrictions against the Franchisee and any relevant person at any time. The persons that are not parties to this Agreement may obtain the benefit of the restrictions agreed to under this Agreement by Notice to the Franchisee and any relevant person stating that a person elects to take and accept the benefit of all or any of the promises and restrictions agreed to by the Franchisee and any relevant person that are contained in this clause 24. This Notice may be given during and after the Term of this Agreement. However, a person that is not a party to this Agreement may only enforce a restriction in this part against one or more of the Franchisee and any relevant person, if that person has our written consent to enforce the restriction.24.10 Exceptions to the restrictions.

The restrictions in this clause 24 agreed to by the Franchisee and any relevant person do not apply to the extent that they obtain the Franchisor's written consent to undertake the restricted activity. Subject to the proviso below, the restrictions do not prevent the Franchisee and any relevant person, during or after this Franchise from owning, holding or acquiring a relevant interest in the issued securities of a listed corporation, which owns or operates:

- (a) a business the same or substantially the same as the Business or the Franchisee's former business in Australia (whether under franchise or not);
- (b) a business the same or substantially the same as the business operated by a master franchisee or Franchisee in Australia (whether under franchise or not).

However, this exclusion only applies if the total securities of that listed corporation held by the Franchisee or any relevant person alone or when added together do not equal or exceed 5% of the total issued securities in the listed corporation. Also, the exclusion only applies if the Franchisee or any relevant person are, during a restraint period of any applicable restriction, not directors, employees, consultants or advisers of or to that listed corporation. The restrictions do not prevent the Franchisee or any relevant person from:

- (a) carrying on, engaging in or owing a relevant interest in its business during this Franchise;
- (b) carrying on, engaging or owing a relevant interest in a business operated by the Franchisee or any relevant person under a master franchise with the Franchisor or under Franchise documents with the Franchisor or other Franchisees in Australia.

24.11 Acknowledgment.

The Franchisee and any relevant person agree that each restriction in this clause 24 is fair and REASONABLE and is intended to help protect or preserve legitimate interests. These include:

- (a) the Franchisor's relationship with its master franchisees and Franchisees;
- (b) the revenue earned by the Franchisor from its business or the business conducted by its master franchisees or Franchisees;
- (c) the Franchisor's goodwill, the goodwill of its master franchisees and Franchisees;
- (d) the trade names and the trade marks and the goodwill connected to them;
- (e) the Confidential Information and the know how;
- (f) the Franchise System and the Corporate Image;
- (g) the Intellectual Property;
- (h) the common trade names or business names used to identify the Franchisor, its business, its master franchisees and Franchisees; and
- (i) the Franchisor's ability to grant a master franchise or a Franchise or the ability of the master franchisees to grant a Franchise.

24.11 Restrictions.

The Franchisee and any relevant person agree that the restrictions in this clause:

- (a) are given for good consideration;
- (b) are reasonably needed to protect legitimate interests;
- (c) will not impose undue hardship on the Franchisee or any relevant person;
- (d) are separate, severable and independent restrictions imposed on the Franchisee or any relevant person;
- (e) apply irrespective of the reason this Agreement ends or is not renewed;
- (f) will not affect any restrictions contained in any other agreements.

24.12 Acknowledgement.

If the Franchisor gives its consent to the Franchisee and any relevant person under clause 24.2, then the restrictions in this clause will not apply to the restriction the Franchisor has consented to.

F3

S28 2yrs and 1 yr, 15,10 and 5 km...interesting construction (s28.5)

S.28 Restrictions on competition

S. 28.1 Restraint of trade

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will directly or indirectly (within the Restraint Area, during the Term and for the Restraint Period without the prior written consent of the Franchisor be concerned or interested in:

- (a) any Italian themed restaurant or café;
- (b) any business that involves the supply or provision of any of the products or services authorised for sale in the course of the Franchisor Business; or
- (c) any form of business similar to that of the Franchisee's business or the Franchisor's business,

or damage the goodwill of the Franchisor or the Franchisor Business.

S.28.2 Conditions of restraint of trade

The Franchisee and its directors, shareholders, Managing Director and any other key employee of the Franchisee and any Principal shall be deemed to have breached clause 0 if any of those persons has an interest in a business described in clause 0 on its own account, or jointly or with or on behalf of any other person, firm or corporation, or is an employee, independent contractor, partner, joint venturer or agent of such a business, or has an interest in such a business through any firm, trust or corporation in which the Franchisee, its directors, officers or shareholders or any Principal may be interested as director, officer, shareholder, beneficial owner of shares, lender, advisor or otherwise.

S.28.3 Concurrent conditions of restraint of trade

Clause 0 shall be construed and take effect as if it were a number of concurrent separate clauses. Each such clause shall be produced by construing one of the limbs of the definition of 'Restraint Period' and one of the limbs of definition of 'Restraint Area' until all possible combinations are exhausted. Each such clause shall be severable from the other clause.

S.28.4 Definitions

In clause 0:

(a) Restraint Period means:

- (i) the period of two years; and
- (ii) the period of one year,
- (iii) after the termination of this agreement; and

(b) Restraint Area means:

- (i) the area of 15 kilometres surrounding the Location;
- (ii) the area of 10 kilometres surrounding the Location; and
- (iii) the area of five kilometres surround the Location.

S.28.5 Clauses enforceable

If any of the separate clauses resulting from the construction of clause 0 in the manner referred to in clause 0 is void or unenforceable for any reason, that voidness or unenforceability shall not prejudice or in any other way affect the validity or enforceability of any other such clause.

S.28.6 Franchisee's warranty for System

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will at any time, either in Australia or overseas, appropriate, use or duplicate the System.

S.28.7 Warranty for non-solicitation of customers or employees

The Franchisee covenants that neither it nor its directors, shareholders, Managing Director nor any other key employee of the Franchisee nor any Principal will at any time within 2 years after the termination of this Agreement:

(a) solicit customers or former customers of the Franchisor Business with the intent of taking their custom for a similar business;

(b) employ or offer to employ any person who:

- (i) immediately before such employment or offer of employment was employed by the Franchisor;
- (ii) immediately before such employment or offer of employment was employed by any person who was at that time operating a business according to the System;
- (iii) employs or offers to employ any person who was so employed at any time during the 2 years preceding such employment; or

(iv) directly or indirectly induce any such person to leave his or her employment.

S.28.8 Directors, shareholders and Principals covenant

The Franchisee must ensure that all directors and shareholders of the Franchisee (in the case of a company being the Franchisee) and the Principal enter into direct covenants of similar content to those contained in clauses 0 - 0 and 0 - 0 above with the Franchisor.

F4

S32: max time and area enforceable by law (5,3,2 or 1 yr)...

Non competition

S32.1 The Franchisee and the guarantor jointly and severally covenant and agree with the Franchisee that:

- (a) During the term of this agreement; and
- (b) for either 5,3,2 or 1 years thereafter (whichever is the greatest period enforceable at law).

Neither the Franchisee or Guarantor(s) shall within the area referred to in s32.3 directly or indirectly, either alone or in partnership, or as a director or shareholder of any company, or as trustee or beneficiary of any trust, or as an EE, consultant, lender, rep., agent, adviser or otherwise:

- (i) be engaged in or carry on business substantially the same or similar to the Franchise pursuant to the agreement or involving the sale of any goods of the same kind as, similar to or competitive with any of the Products; and (ii) employ any EEs or former EEs who were employed in the Zise or by the Franchisee in a business referred to at (i).

S32.2 The area of restraint shall be:

- (a) The franchise delivery area; and (b) The area within a radius of 10, 5,3,2,1 or ½ kms (whichever is the greatest area enforceable at law) from the premises or any store operated by the Franchisee.

S32.3 The Franchisee also covenants to ensure that the Nominated Manager does similarly engaged (in any capacity) in any such like or conflicting businesses to the Franchisee.

S32.5 The Franchisee and the guarantor agree that the restraints contained in s32 are fair and reasonable to protect the efforts of the Franchisee in developing the system and Intellectual

property and the business of other Franchisees and that the Franchisee and the guarantor have received adequate consideration for these restraints.

F5

S. 75 Covenant not to compete

You and the covenantor jointly and severally agree that during the term of this agreement, and for a period of 12 months after its termination you and the covenantor will not, in any capacity whatsoever, carry on any business substantially the same as the franchise business or involving the sale of any goods similar to or competitive

with any of the authorised products within the territory or within the territory of any other franchise granted by us in Australia or New Zealand.

F6

34.1 Extent of Restraint

For the purpose of protecting FRANCHISOR's Business and the FRANCHISOR SYSTEM and in consideration of the benefits to be derived by it from this agreement the Franchisee covenants to and with FRANCHISOR that it, the Guarantors and the Nominated Manager shall not (and where the Franchisee is a corporation it covenants to procure that each related body corporate shall not) during the term of this agreement and for a period of :

- (a) 1 year from the Termination Date;
- (b) 9 months from the Termination Date;
- (c) 6 months from the Termination Date;

without the prior written consent of FRANCHISOR, carry on or be engaged in the Restricted Activities within

- (d) 2 kilometres of the Premises;
- (e) 1 kilometre of the Premises;
- (f) 1/2 kilometre of the Premises;
- (g) the shopping centre, shopping strip or shopping mall within which the Premises are located.

It is intended that the primary restraint is set out in paragraphs (a) and (d) and that:

- (1) paragraph (b) is a separate alternative to be applied only if paragraph (a) constitutes an invalid restraint;
- (2) paragraph (c) is a separate alternative to be applied only if paragraphs (a) and (b) constitute an invalid restraint.
- (3) paragraph (e) is a separate alternative to be applied only if paragraph (d) constitutes an invalid restraint;
- (4) paragraph (f) is a separate alternative to be applied only if paragraphs (d) and (e) constitute an invalid restraint.
- (5) paragraph (g) is a separate alternative to be applied only if paragraphs (d), (e) and (f) constitute an invalid restraint.

For the purpose of clause 34.1:

- (a) "any capacity" means acting on a person's own account as a principal, agent, owner, joint venturer, partner, shareholder, unit holder, director, secretary, company officer, trustee, manager, employee, adviser, consultant or otherwise, whether jointly with or on behalf of any other person or by means of an agent, independent contractor or employee of any person in which the person may be interested as an employee, officer, shareholder, beneficial or legal owner of shares, lender or adviser or otherwise;
- (b) "engaged" means engaged in any capacity whether directly or indirectly, on the Franchisee's own behalf or on behalf of any other person;
- (c) "Restricted Activities" means:

- (1) soliciting or endeavouring to solicit or entice away from FRANCHISOR or its franchisees any officer, manager or employee of FRANCHISOR or any person who later becomes an officer, manager or employee of FRANCHISOR or its franchisees, whether or not that person would commit any breach of that person's contract of employment;
- (2) employing any person who being a director, manager, employee of or consultant to FRANCHISOR or its franchisees during the Term of this agreement who is in possession of any confidential information or trade secrets relating to:
 - (A) FRANCHISOR's business; or
 - (B) the customers of FRANCHISOR;
- (3) soliciting or accepting business for the supply of any goods or services of the general descriptions of any of those supplied by FRANCHISOR's Business within 12 months before the Termination Date from any person that has dealt with or transacted business with FRANCHISOR or its franchisees:
 - (A) at any time during the 2 years prior to the Termination Date;
 - (B) at any time during the 18 months prior to the Termination Date;
 - (C) at any time during the 12 months prior to the Termination Date;
 - (D) at any time during the 6 months prior to the Termination Date;

Date;
Date;
Date,

and it is intended that the primary restraint is set out in paragraph (A), that paragraph (B) is a separate alternative to be applied only if paragraph (A) constitutes an invalid restraint, that paragraph (C) is a separate alternative to be applied only if paragraph (B) constitutes an invalid restraint, and that paragraph (D) is a separate alternative to be applied only if paragraph (C) constitutes an invalid restraint;

- (4) disclosing to any third party or using at any time any trade secrets, product information or confidential information of FRANCHISOR's Business and FRANCHISOR SYSTEM which is generally not known or available in the market place or which but for a breach of this clause 34.1 would not be generally known or available in the market place;
- (5) being engaged or concerned or interested, whether directly or indirectly, in any capacity in any company, firm or business which is or is about to be engaged in, or whose principal business is the business of retail selling of furniture;

(d) "Termination Date" means the date of termination or expiration (for any reason) of the Franchisee's appointment under this agreement.

34.2 Extent of restraint

- (a) The Franchisee and FRANCHISOR consider each of the restraints contained in clause 34.1 to be REASONABLE for the purposes of protecting the proper interests of FRANCHISOR in FRANCHISOR's Business and intend the restraints to operate to the maximum extent.
- (b) If these restraints:
 - (1) are void as unreasonable for the protection of the interests of FRANCHISOR; and
 - (2) would be valid if part of the wording was deleted or the period or area was reduced,
 the restraints will apply with the modifications necessary to make them effective.
- (c) The restraints contained in clause 34.1 are separate, distinct and several. If any restraint is unenforceable, it may be severed without affecting the remaining enforceability of the other restraints.

F7

27.2 Franchisee Must Not Compete Unfairly

The Franchisee and the Guarantor (if any) jointly and severally agree with the Franchisor that neither the Franchisee nor any Guarantor will, during the Restraint Period and within the Restraint Area, directly or indirectly do any of the following things:

1. engage or be concerned or interested in any business that:
 - (a) supplies products or services the same as or similar to those at any time supplied in the Business; or
 - (b) could be reasonably regarded as a market competitor of the Network or any ## Business; or
2. canvass or solicit with a view to supplying any product or service the same as or similar to those at any time supplied in the conduct of the Business, any person who is or has been in the 12 months before the end of the Franchise a customer of the Business or of any other ## Business; or
3. employ or engage any person who is or has been in the 12 months before the end of the Franchise employed by the Franchisor, the Franchisee or any other ## Franchisee, without first obtaining the Franchisor's written consent.

27.3 Restraint Applies to Conduct of Franchisee in any Capacity

The agreement by the Franchisee and the Guarantor in clause 27.2 applies to any of them acting:
 either alone or in partnership or association with another person;
 as principal, agent, representative, director, officer or employee;
 as member, shareholder, debenture holder, noteholder or holder of any other security;
 as trustee of or as a consultant or adviser to any person; or
 in any other capacity.

Separate Restraint Agreements

Clauses 27.2 and 27.3 have effect as comprising each of the separate provisions which results from each combination of a capacity referred to in clause 27.3 and a category of conduct referred to in clause 27.2. Each of these separate provisions operates concurrently and independently. If any separate provision is unenforceable, illegal or void that provision is severed and the other separate provisions remain in force.

The Franchisee must ensure that the Manager and any of its key employees nominated by the Franchisor enter into service or employment contracts in a form approved by the Franchisor which contain a similar REASONABLE restraint as imposed on the Franchisee and Guarantor pursuant to this clause 27.

F8

3 Licencee's duties

3.7 Run a similar business – The Licencee shall not during the Term either directly or indirectly carry on any business similar to the Licenced Operation whether on the Licencee's own account or as nominee, agent, servant, representative, employee, shareholder or director in any firm or corporation conducting such a business.

3.8 Non Competition Covenant – The Licencee shall:

3.8.1 if it is a corporation, procure its directors and shareholders from time to time; or

3.8.2 if it is a partnership, procure its partners from time to time; or

3.8.3 if it is a trustee

enter into a covenant with the Licensor in the terms of the covenant annexed to this Agreement marked "a".

3.9 The Licencee shall use the Licencee's best endeavours to ensure that staff employed do not engage (in any capacity) in any similar business to the Licenced Operation during the Term.

F9

11.1 Engagement in Similar Business -

The Franchisee hereby acknowledges that the business reputation of the Franchisor and Franchisor, the methods and procedures used by the Franchisor and Franchisor, the training to be provided, the Franchisor System among other things, the opportunities and experiences acquired or to be acquired by the Franchisee hereunder are of considerable value and benefit. Accordingly, the Franchisee hereby acknowledges and agrees as follows:

(1) during the Term, the Franchisee shall not, either directly or indirectly, individually or as a director, officer, employee, shareholder or member of any corporation or other entity, or in any other capacity whatsoever, engage in, be concerned with or interested in, advise, lend money to, guarantee the obligations of, or permit its name to be used in:

(a) any business which is the same or similar to, or otherwise is operating in competition with, the Business and/or

- (b) any business (whether of a wholesale or other nature) where the prime source of income of such business is or is to be derived from the sale of popcorn or popcorn related products;
- (2) upon the termination of this agreement for any reason whatsoever, or if the Franchisee sells, assigns, transfers: or otherwise disposes of its interest in the Business, then for a period of 1 year following such termination, or sale, assignment, transfer, or disposal, Franchisee shall not, either directly or indirectly, individually or as a director, officer, employee, shareholder or member of any corporation or other entity, or in any other capacity whatsoever, engage in, be concerned with or interested in, advise, lend money to, guarantee the obligations of, or permit its name to be used in, any business which is the same or similar to, or otherwise is operating in competition with, the business formerly conducted by the Franchisee and which is located anywhere within a 5 mile radius of the Premises, or within a 5 mile radius of any location of the Franchisor Franchisor or of any location of a franchisee of the Franchisor or of Franchisor from which a business is being operated using the Franchisor System and the Trademark;
- (3) that all information (whether oral or written) disclosed to the Franchisee by or on behalf of the Franchisor or Franchisor pursuant to this agreement or the Franchisor System has been disclosed to the Franchisee in the strictest of confidence and/or as trade secrets and accordingly, the Franchisee agrees that it will not, either during the Term or at any time thereafter, disclose any information with respect to the Business, or any system, procedures, documents, methods or otherwise that it may obtain from or on behalf of the Franchisor or Franchisor pursuant to this agreement, nor will the Franchisee for its own purposes or any other purposes, disclose to anyone any information or knowledge it may acquire with respect to the Franchisor System or the Franchisor's or Franchisor's business.

11.2 Change of Geographical Area or Time Period –

The Franchisor and the Franchisee agree that if a court of competent jurisdiction shall limit, restrict or otherwise change the geographical area or time period referred to in this clause 11, that the limited, restricted, or changed geographical area or time period determined by the said court shall, for the purposes of this clause 11, be deemed to be the geographical area and/or time period referred to in this clause 11, as if they were the original geographical area and time period set out herein.

11.3 Non Competition and/or Non Disclosure Acknowledgment –

If the Franchisee or any Guarantor hereto is a corporation or other entity (other than an individual person), the Franchisee and/or such Guarantor agree to deliver to the Franchisor at such time as the Franchisor may request, the written acknowledgment of such directors, officers, shareholders, members or employees of the Franchisee and/or the Guarantor, as the Franchisor shall in its discretion require, acknowledging that such director, officer, shareholder, member or employee has reviewed the provisions of this clause 11 and that he, she or it agrees to be bound by all of such provisions of this clause 11 as the Franchisor may specify. The form of acknowledgment to be executed pursuant hereto shall be in such form as may be required by the Franchisor from time to time.

F10 - Old

Covenant against competition

- 7.1 The Franchisee must not during the term of this Agreement and for a period of twelve (12) months after the termination or expiration of this Agreement commence, engage in, conduct, carry on, have any direct or indirect interest in, be employed or retained in any capacity by a Business or other enterprise offering the same or similar services as the Franchise Business and which is located or operating:
- in the Territory; or
 - within an area being within a radius of 20 kilometers of the territory Franchised Business, or any other Franchised Business.
- 7.2 Where the Franchisee is a body corporate, each and every director of the Franchise agrees and undertakes to be bound by the covenant referred to in Clause 7.1 of this agreement and undertaking shall be evidenced by the guarantee given by each and every director in Annexure B to this Agreement.
- 7.3 The Franchisee agrees and declares that it shall not hire or employ or otherwise engage employees of the Franchisors or other franchisees or induce such employees to leave their employment during the term(s) of this Agreement and for a period of twelve (12) months thereafter.
- 7.4 The Franchisee:
covenants and declares that Clauses 7.1, 7.2 and 7.3 shall survive this Agreement should it be terminated or come to an end; and
agrees that if, for any reason whatsoever, those clauses are rendered void, unenforceable or otherwise ineffective that shall not affect the enforceability or effectiveness of any other terms or conditions of this Agreement.
- 7.5 In Clauses 7.1, 7.2, 7.3 and 7.4, a reference to the Franchisee includes a reference to its directors, shareholders, partners or beneficiaries.

F10 - Proposed

Covenant against competition - During the term of this Agreement, the Franchisee must not be involved with any business offering similar services within twenty kilometers of the territory.

F11

30 Restraints

30.1 Employment – The Coach, the Guarantors (if any) and the Manager must not during the Term or for six (6) months after the Term, without the written consent of Franchisor:

- (a) employ or offer to employ any person who was employed by Franchisor or an Franchisor Coach within the twelve (12) month period immediately prior to the offer of employment; or
- (b) directly or indirectly induce any person to leave his employment with Franchisor or a Franchisor Coach

30.2 Restraint During Term – the Coach, the Guarantors (if any) and the Manager must not during the Term either: -

- (a) alone;
- (b) jointly with or on behalf of any other person, firm or corporation or as an employee, independent contractor, partner, joint venturer or agent;
- (c) as an officer of any person, firm or corporation;
- (d) as a shareholder of any corporation; or
- (e) as trustee of any trust,

be engaged, concerned or interested in or permit his name to be used in connection with any other business which competes with the Business except without the prior written consent of Franchisor, which must not be unreasonably withheld.

30.3 Restrain After Term – The Coach, the Guarantors (if any) and the Manager must not for any of the periods mentioned in this clause either: -

- (a) alone;
- (b) jointly with or on behalf of any other person, firm or corporation or as an employee, independent contractor, partner, joint venturer or agent;
- (c) as an officer of any person, firm or corporation;
- (d) as a shareholder of any corporation; or
- (e) as trustee of any trust

be engaged, concerned or interested in any business which competes with Franchisor's Business or permit his name to be used in connection with any such business in Australia or if the Coach did not have Clients throughout Australian then in the area where the Coach provided the majority of Services during any of the following periods: -

- (i) the period three (3) years commencing on the Completion Date; or
- (ii) for a period two (2) years commencing on the Completion Date; or
- (iii) for a period of one (1) year commencing on the Completion Date.

If any part of this clause is held or found to be void or unenforceable, it will be severed from this clause to the extent of the voidness or unenforceability and the remainder of this clause will remain in full force and effect.

30.4 Past Business –

The parties acknowledge that the Coach and the Guarantor (if any) have in the past conducted businesses which were similar to but not competitive with Franchisor's business. The Coach and/or the Guarantors may wish to continue those businesses after the end of this Agreement. Nothing in this Clause 30 is meant to prevent the Coach from carrying on the other business which is not directly meant to prevent the Coach from carrying on the other business which is not directly in competition with the Franchisor's Business. As the Business is not in competition with the Franchisor's Business, the terms of Clauses 30.2 and 30.3 will not apply.

30.5 Reasonable –

The parties acknowledge that the restraints contained in this clause 30 are reasonable and necessary to protect the goodwill of Franchisor.

8.5 No Competition

8.5.1 The Franchisee and the Nominated Operator must not, during the Term, whether as principal, employee, consultant, agent, partner, shareholder or director, carry on, be engaged in, or be directly or indirectly associated with, any other business or activity:

8.5.1.1 Similar to or competitive with the Business;

8.5.1.3 Which competes with the Franchisor in its marketing and distribution of the Products and the Services;

8.5.1.4 Which competes with any other Franchisee of the Franchisor.

8.5.2 The Franchisee must not during the Term and for one (1) year after the Term seek to employ or engage any employee or agent of the Franchisor or any employee of another the Franchisor's Franchisees.

11.7 No Competition

11.7.1 The Franchisee must not, as principal, employee, consultant, advisor, shareholder, representative, agent, director or otherwise:

11.7.1.1 market, procure supply of or supply to a Client products or services similar to or competitive with products or services marketed, procured or supplied by a business similar to the Business:

11.7.1.1.1 within 2 years after the expiration or earlier termination of this agreement;

11.7.1.1.2 within 1 year after the expiration or earlier termination of this agreement;

11.7.1.1.3 within 6 months after the expiration or earlier termination of this agreement.

11.7.1.2 within the following areas:

11.7.1.2.1 the State of Queensland;

11.7.1.2.2 within a 50km radius of the Premises;

11.7.1.2.3 within a 20km radius of the Premises

11.7.1.2.4 within a 5 km radius of the Premises

11.7.2 Clause 12.3.1 is read as if each possible combination of:

11.7.2.1 the capacities in clause 12.3.1;

11.7.2.2 a conduct in clause 12.3.1.1:

11.7.2.3 a period in clauses 12.3.1.1.1 to 12.3.1.1.3; and an

11.7.2.4 area in clauses 12.3.1.2.1 to 12.3.1.2.4,

is a separate clause. All these combinations apply cumulatively. Each combination must be read down to the extent necessary to be valid. If any combination cannot be read down to that extent, it must be severed.

11.7.3 For the purpose of clause 12.3.1, a Client is a person who:

11.7.3.1 has used or uses a financial related service introduced by the Franchisee during the Term in respect of which the Franchisee has

received in the period of 24 months prior to the expiration or earlier termination of this agreement, any commission, fee or other remuneration.

- 11.7.4 The Franchisee acknowledges and agrees that the restraints contained in this agreement and each combination of them are reasonably necessary for the protection of the " " System and the Franchisor's Business and that the Franchisor's interests (given its widest possible interpretation) would suffer loss or damage by competition with the Franchisee (or related entities of the Franchisee) if these restraints had not been imposed, and further that the Franchisor may not be adequately compensated for such loss or damage only by the payment of damages.

F13

S12.3 Except as a shareholder, and during the specified period after the end of this agreement:

- (A) Franchisee and Franchisee's directors, if Franchisee is a corporation, must not conduct on Franchisee's own acct or be concerned or interested in any firm or corp conducting a business similar to the Zise within the specified area and whether directly or indirectly as an agent, representative, servant, employee, shareholder or director.

F14

Restraints in respect of other businesses

- 26 You and the Guarantors must not during the term of this Agreement carry on or in any way be involved in any other business without our prior written consent. We will not unreasonably withhold our consent if we are satisfied that the conduct of such other business will not interfere with the proper operation of your Bakers Delight Business in accordance with this Agreement and will not affect our legitimate business interests.
- 27 You and the Guarantors must not for a period of 2 years after the termination of this Agreement carry on or in any way be involved in any business of a like or similar nature to a Bakers Delight Business within a radius of 5 kilometres of any Bakers Delight Business (whether owned or operated by us or by a franchisee). You acknowledge that this restraint is reasonably required to protect our legitimate business interests and those of our franchisees. You also acknowledge that by the insertion of a similar clause in other franchise agreements you will gain the benefit of the prohibition on other former franchisees from competing with you.

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6. FRANCHISEE'S GENERAL OBLIGATIONS

6.1 Not to compete. The Franchisee hereby covenants and agrees with the Franchisor for the benefit of the Franchisor as follows:

- (a) (i) The Franchisee acknowledges that the success or otherwise of the System, the Franchised Operation and the Business relies heavily on the personal efforts of the Franchisee and or the Guarantors and or the Nominated Person (as the case may be), the intent being that the Franchisee and or the Guarantors and or the Nominated Person (as the case may be) will devote and direct their time, effort, energy and expertise towards the efficient and profitable operation of the Business.
- (ii) To that end, the Franchisee and each of the Guarantors (and if more than one, then jointly and severally), covenant and agree with the Franchisor, for the benefit of each other, and all other franchisees in the System that they will not, as officers, shareholders, manager, servant, agent, partner or otherwise, either directly or indirectly during the Term, be involved in, or carry on any business of a like or similar nature to the Business, the Franchise or the System without the prior consent in writing of the Franchisor;
- (iii) The Franchisor's consent shall not be unreasonably refused to any request of the Franchisee for a relaxation of the restraints imposed herein in circumstances where the Franchisee can demonstrate to the complete satisfaction of the Franchisor that such a relaxation will not effect the efficient and profitable conduct of the Franchised Operation including the Business and will not be to the detriment of the System, the Franchisor or other Franchisor franchisees.
- (iv) Notwithstanding the foregoing, the Franchisee and the Guarantors acknowledge that the restraints contained in this Clause 6.1 (a) (iii) are no more than are reasonably required to protect the interests of the Franchisor and all franchisees in and the goodwill attaching to, the System, the Intellectual Property, the Names and Marks;
- (v) The provisions of Clause 6.1 (a) (iii) and the restraints imposed do not apply to the circumstance where the Franchisee owns, operates, manages or is the nominated person in respect of another Franchisor franchise or franchised operation (with the consent of the Franchisor) during the Term.
- (b) the Franchisee and each of the Guarantors (if more than one, jointly and severally) agree that they will not directly or indirectly and whether solely or jointly with or as Director, manager, agent or servant of any person or corporation carry on or be engaged or interested in any business of the nature of the Franchised Operation within and during the Non Compete Area and Period after the termination or expiration of this Agreement.

Notwithstanding the foregoing, the Franchisee and the Guarantors acknowledge that the restraints contained in this Clause 6.1 (b) are no more than are reasonably required to protect the interests of the Franchisor and all franchisees in and the goodwill attaching to, the System, the Intellectual Property, the Names and Marks.

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8.12 Non-Competition (an executed Deed is required - Annexure E)

- (a) The Master Franchisee agrees that during the Term and any renewal thereof the Master Franchisee shall not engage in or have any direct or indirect interest whether as an owner, partner, director, shareholder, officer, employee, agent, consultant, representative, contractor or sub-contractor or in any other capacity direct or indirect, in the provision of home services within the Master Franchise Area or within any Area in any state or Country in which another James' Home Services franchise is operating.
- (b) ... The parties hereby expressly agree that the order of priority of the restraints is as follows:
 Upon surrender, expiry or termination of this agreement for any reason the Master Franchisee shall not for a period of –
- (a) two (2) years;
 - (b) one (1) year;
 - (c) six (6) months,
- after such surrender, expiry or termination have any direct or indirect interest whether as –
- (d) owner;
 - (e) partner;
 - (f) director;
 - (g) employee;
 - (h) agent;
- in the business of –
- (i) acting as a Franchisor, a State Master Franchisee, a Master Franchisee or in a capacity similar to a Franchisor, State Master Franchisee or Master Franchisee in relation to the provision of Home Services or a Home Service Business;
 - (j) mobile car cleaning;
 - (k) carpet cleaning and pest control;
 - (l) windows and exterior house cleaning;
 - (m) lawn and garden care;
 - (n) interior house care
 - (o) hydrobath and pet grooming;
 - (p) mobile ironing and laundry service
- within –
- (q) the Master Franchise Area;
 - (r) James' Home Services State or Regional Master Franchise Areas or Franchise Areas that adjoin the Area;
 - (s) within a radius of five hundred (500) kilometres from the premises (as at the date of termination);
 - (t) within a radius of two hundred (200) kilometres from the premises (as at the date of termination);
 - (u) within a radius of fifty (50) kilometres from the premises (as at the date of termination);
 - (v) within the radius of twenty (2) kilometres from the premises (as at the date of termination).

10.11 Restrictions

During the franchise term, you must not at or in connection with your business or the store, without our consent:

- trade under a trade or business name we have not approved;
- supply food, beverages, goods or services that are not approved in the manuals, do not meet the system standards or that may damage the system, the image or our or your reputation;
- use ingredients in the making of food or beverages after the recommended ingredient life of the item has expired;
- do anything that may give rise to industrial action against you or other operators of Franchisor stores; use, publish, sell or distribute marketing materials that we have not approved;
- permit the broadcast from TVs, videos or audio equipment within the store of any material that is obscene or illegal;
- keep vending machines, gaming or pinball machines, video games or rides;
- make material changes to the inside and outside of the store, its decor, get up or appearance; and display or use trade names, trade marks, signs, decor or getup that we have not approved.

PART 30 NON-COMPETITION

30.1 Restrictions on running other coffee shops or cafes during your franchise term

During your franchise term, you and your associates must not, without our consent, whether on your or your associates own account or together with or for anyone else or as a sale trader, partner or employee of any partnership or as a shareholder, director, officer, employee, consultant, manager of a company (in its personal capacity or as trustee), as a trustee, beneficiary or unitholder of a trust, own, have a legal, beneficial, proprietary or financial interest in, carry on, engage in, be employed in any other coffee shop or cafe that is the same as, substantially or sufficiently similar to your business if those other similar competing coffee shop or cafe is or are located or operated anywhere within:

- all or any of a 3km, 2km, 1 km or 1/2km radius from the centre of: the site(s) then currently used by your business; and/or
- any former site(s) used by your business in the 2 years before your business started trading from its latest or then current site(s); and/or
- the site(s) of any other Franchisor store that is open and trading at the time that you or your associates start or undertake any of those restricted activities referred to in this clause 30.1 if the relevant other Franchisor store(s) is or are located or operated anywhere within:
- the city or town in Australia in which your business is then currently located or operated; and/or
- the state or territory in Australia in which your business is then currently located or operated; and/or Australia;
- the same building(s), shopping centre(s) or complex(s) in which your business is then currently located or operated;
- permit your directors and employees to assist in the management or operation of anyone or more of those

- similar competing coffee shop or cafe referred to in clause 30.1 above.
- Restrictions on running other coffee shops or cafes after you sell your business or after your franchise term expires or ends
- For all or any of 3 years, 2 years or 1 year after the settlement of the contract for the sale of your business or the expiry or end of this agreement, you and your associates must not, without our consent, whether on your or your associates own account or together with or for anyone else or as a sale trader, partner or employee of any partnership or as a shareholder, director, officer, employee, consultant, manager of a company (in its personal capacity or as trustee) or as a trustee, beneficiary or unitholder of a trust,
- Own, have a legal, beneficial, proprietary or financial interest in, carry on, engage in, be employed in, a coffee shop or cafe that is the same as, substantially or sufficiently similar to your business or your former business (a similar competing coffee shop or cafe) if any such competing coffee shop or cafe is or are located or operated anywhere within:
 - all or any of a 3km, 2km, 1 km or 1/2km radius from the centre of:
 - the site(s) of your business or your former business at the time the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
 - any site(s) used by your business or your former business in the 2 years before the contract for the sale of your business was made or the date of expiry or ending of this agreement; and/or
 - the site(s) of any other Franchisor store(s) that is or are open and trading at the time that you or your associates start or undertake any of those restricted activities referred to in clause 30.2 if the relevant other Franchisor store(s) is or are located or operated anywhere within:
 - the city or town in Australia in which your business is located or operated or your former business was last located or operated; and/or
 - the state or territory in Australia in which your business is located or operated or your former business was last located or operated; and/or
 - Australia; and/or
 - the same building(s), shopping centre(s) or other complex(s) in which:
 - your business is located or operated from or from which your former business was located or operated from at the time the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
 - the site(s) of any other Franchisor store {s) that is or are open and trading at the time that you or your associates start or undertake any of those restricted activities referred to in clause 30.2 if the relevant other Franchisor store {s) is or are located or operated anywhere within:
 - the city or town in Australia in which your business is located or operated or your former business was last located or operated; and/or
 - the state or territory in Australia in which your business is located or operated or your former business was last located or operated; and/or
 - Australia; and/or
 - the site(s) of your business or your former business at the time that the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
 - any site(s) used by your former business in the 2 years before the contract for the sale of your business is made or the date of expiry or ending of this agreement; or
 - engage in or be employed in a whole, substantial, or material part in the preparation and retail selling of coffee beverages or other foods or beverages

that are the same as, substantially or sufficiently similar to those that are or were actually sold from your business or your former business in, for or from a coffee shop or cafe, for consumption mainly within the coffee shop or cafe or any nearby dining or eating area serviced by the coffee shop or cafe (a similar competing coffee shop or cafe) to the customers that are or were your existing or established customers at or at any time 1 year before the contract for the sale of your business is made or the expiry or ending of this agreement where any such similar competing coffee shop or cafe is or are located or operated anywhere within:

- all or any of a 3km, 2km, 1 km or 1/2km radius from the centre of:
- the site(s) of your business or your former business at the time that the contract for sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
- any site(s) used by your business or your former business in the 2 years before the contract for the sale of your business is made or the date of expiry or end of this agreement; and/or
- the same building(s), shopping centre(s) or other complex(s) in which your business is located or operated or your former business was last located or operated; and/or
- the site(s) of your business or your former business at the time that the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
- any site(s) used by your former business in the 2 years before the contract for the sale of your business is made or the date of expiry or ending of this agreement; and/or
- engage in or be employed in a whole, substantial, or material part in the preparation and retail selling of coffee beverages, foods or other beverages that are the same as, substantially or sufficiently similar to those that are or were actually sold from your business or your former business in, for or from a coffee shop or cafe (a similar competing coffee shop or cafe) to the customers that are or were the existing or established customers of any other operator of a Franchisor store whose store(s) is or are located or operated anywhere within:

30.4 For all or any of 3 years, 2 years or 1 year after settlement of the contract for the sale of your business or the expiry or the end of this agreement, you and your associates must not, without our consent, whether on your or your associates own account or together with or for anyone else or as a sale trader, partner or employee in any partnership or as a shareholder, director, officer, employee, consultant, manager of a company (in its personal capacity or as trustee) or as a trustee, beneficiary or unitholder of a trust, do anything restricted by clause 30.5 in, for or from a coffee shop or cafe that is the same or substantially similar to your business or your former business (a similar competing coffee shop or cafe) if that similar competing coffee shop or cafe is or are located or operated anywhere within:

all or any of a 3km, 2km, 1 km or 1/2km radius from the centre of:

- the site(s) of your business at the time that the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
- any site(s) used by your former business in the 2 years before the contract for the sale of your business is made or the date of expiry or end of this agreement: or

- the site(s) of any other Franchisor store that is open and trading at the time that you or your associates start or undertake any of the restricted activities referred to in clause 30.5, if the relevant other Franchisor store(s) is or are located or operated within:
- the city or town in Australia in which your business is located or operated or your former business was last located or operated; and/or
- the state or territory in Australia in which your business is located or operated or your former business was last located or operated: and/or
- Australia; and/or
- the same building(s), shopping centre(s) or other complex(s) in which:
- your business is located or operated from or your former business was last located or operated from; or the site(s) of any other Franchisor store that is open and trading at the time that you or your associates start or undertake any of those restricted activities referred to in clause 30.5, if the relevant other Franchisor store(s) is or are located or operated within:
- the city or town in Australia in which your business is located or operated or your former business was last located or operated; and/or
- the state or territory in Australia in which your business is located or operated or your former business was last located or operated; and/or
- the site(s) of your business at the time that the contract for the sale of your business was made or immediately before the date of expiry or ending of this agreement; and/or
- any site(s) used by your former business in the 2 years before the contract for the sale of your business is made or the date of expiry or end of this agreement.
- You and your associates must not:
- solicit, canvas or entice any customers that are or were your existing or established customers in connection with your business or your former business at or at any time 1 year before the contract for the sale of your business is made or before the expiry or end of this agreement, with the object of, purpose or intention of offering to sell or selling to those existing or established customers coffee beverages or other food or beverages that are the same as or substantially similar to the coffee beverages or other food or beverages that are or were actually supplied from your business or your former business at any time 1 year before the contract for the sale of your business is made or the expiry or end of this agreement;
- solicit, canvas or entice any customers that are or were the existing or established customers of any other operator of a Franchisor store referred to in clause 30.4 above, at or at any time 1 year before the contract for the sale of your business is made or before the expiry or end of this agreement, with the object of, purpose or intention of offering to sell or selling to those existing or established customers coffee beverages or other food or beverages that are the same or substantially similar to the coffee beverages or other food or beverages that are or were actually supplied from your business or your former business at any time 1 year before the contract for the sale of your business is made or the expiry or end of this agreement;
- use, allow anyone else to use, copy or sell:
- the distinctive, characteristic or identifying features of the system or the image of a Franchisor store; the Franchisor intellectual property or any colourable imitation of it: and/or
- the trade names or trade marks; and/or
- confidential information about your customers; and/or
- confidential information about customers of other operators of Franchisor store whose store(s) is or are located or operated in Australia; and/or

- the confidential information or the know how; and/or
- your databases, in particular any customer database including any commercially sensitive information kept on any of your databases; and/or
- plans and/or the layout of a Franchisor store including kitchen and equipment design and layout; and/or
- colour patterns or combinations, get up, decor or appearance of or used in a Franchisor store; and/or any current or former Franchisor food or beverage menus used in a Franchisor store; and/or
- the manuals including all Franchisor food and beverage manuals; and or
- the licenced software (if any); and/or
- the proprietary copyrights (if any) developed by or for us or our associates for use in connection with the system, the image or a Franchisor store; and/or
- the distinctive characteristics or identifying advertising or promotions used to market or promote the sale of coffee, food or beverages sold from a Franchisor store; and/or
- special, proprietary or secret recipes, formulas used to make, prepare, present or serve food or beverages listed in the Franchisor food or beverages menus; and/or
- the methods or procedures used to prepare, cook, pack and sell food and beverages approved for sale from a Franchisor store;
- the Franchisor uniforms, dress styles or costumes that are or were used in connection with a Franchisor store by its managers, chefs, kitchenhands and employees; and/or
- name, address or other details of your present or established customers at or 1 year before the contract for the safe of your business is made or the expiry or end of this agreement; and/or
- sell, disclose or use the confidential information or know how kept or obtained from your database including any details of your customers maintained on any database kept by or for you; and/or
- sell, disclose or use the confidential information or know how for the possible benefit of a competing franchisor, subfranchisor or other operator of a coffee shop or cafe that is the same as, substantially or sufficiently similar to or in competition with your business or your former business.

31.2 Restrictions on use of confidential information

"Subject to clause 31.3, during and after the franchise term, you and your associates must not for any purpose or for anyone else directly or indirectly allow disclosure, communication, use, reproduction, memorisation, copying, retrieval, printing, reverse engineering, sale or other dealing of or with the confidential information not authorised by this agreement or by us in writing.

PART 32 INJUNCTIVE RELIEF FOR BREACHES OF NON-COMPETITION AND CONFIDENTIALITY

- 32.1 If there is an actual or threatened breach of a duty under Part 30 (Non-competition) or in Part 31 (Confidential information) by you or your associates, we, our associates or any other beneficiary entitled to enforce the relevant promises and who has been or is likely to be affected may seek and have the right to a temporary or interim injunction (pending trial) restraining anyone or more of you or your associates from breaching the duties under

either or both Part 30 or Part 31 without having to show or prove on the hearing of any application or motion for an injunction, a proprietary right or any special or actual damage has been or will be sustained or incurred. This right will be in addition to any other relief or orders that a court may order to secure or support compliance by you or your associates under either or both Part 30 or Part 31.

- 32.2 During and after the franchise term, in connection with proceedings by us or our associates or other beneficiaries entitled to enforce the relevant promises for a temporary or interim injunction (pending trial) for a breach of the duties under either or both Part 30 or Part 31, you and your associates will not seek any order for security for cost from us or our associates in connection with any proceedings for a temporary or interim injunction except for the usual undertaking as to damages required by the rules of the court to which a motion or application for an injunction or other relief has been made.

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No restrictions post termination of the Franchise Agreement have been stipulated, i.e. no set amount of years before the Franchisee can “open-up shop” elsewhere. However the following covenants are stated.

- 2.3 The Franchise shall be subject to the following qualifications and restrictions

(c) Colonial reserves the right to appoint new Franchise Owners, agents or representatives without restriction.

- 33.5 Furthermore the Principals personally covenant and acknowledge as follows:

- (a) That they will not act in a manner which, if they were the Franchise Owner or the Nominated Representative, would be a breach of this Agreement or the Collateral Agreements by the Franchise Owner or the Nominated Representative, and accordingly the Principals guarantee their own due and prompt performance and observance of any and all covenants obligations terms and conditions contained in this Agreement or any of the Collateral Agreements;
- (b) that Colonial will be entitled to apply for and obtain temporary or permanent injunctions, declarations and orders for specific performance in the event of any breach or threatened breach of any covenant or provision of this clause.

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- 13 Conduct of Business and Staff

... (b) The member must not carry on the Business at any premises other than the Location without first obtaining the written approval of the Company which may be given withheld by the Company at its discretion or given subject to conditions, including without limitation, conditions in relation to the manner in which the premises is identified as the Retail Brand.

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