

RECONCEIVING THE REGULATION OF THE FRANCHISE SECTOR

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INTRODUCTION

The franchising sector contributes an estimated \$90 billion per year (about 11%) to the Gross Domestic Product and employs over 600 000 people in Australia, a figure that between 2002 and 2004 increased by about fourteen percent and between 2004 and 2006 by about thirteen percent¹ Despite its importance to the national economy, there is little reliable evidence of the economic effectiveness of the operation of the sector. Franchising is portrayed by its trade association as a vehicle to transform inexperienced people into successful business owners, with higher success rates than for independent small business. The following quotes from the Franchising Council of Australia (the FCA) website give a sense of the 'promise' of franchising:

There are countless benefits to becoming a Franchisee, which is why Franchising is one of the fastest-growing sectors of the Australian economy.

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

It is also a Win-Win relationship where the franchisor is able to expand its market presence without eroding its own capital, and the franchisee gains through access to established business systems, at lower risk, for their own commercial advantage.²

Despite such claims, stories persist of would-be entrepreneurs for whom the experience of franchising has been costly and disappointing.³

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¹ 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 Lorelle Frazer, Scott Weaven, and Owen Wright, *Franchising Australia 2006 Survey* (2006) available at <http://www.franchise.org.au>. Despite current economic conditions, the most recent indications are that the franchise sector in Australia has not to date experienced a slow-down.

² These three quotes are taken from Franchise Council of Australia, *What is Franchising?* (2008) <<http://www.franchise.org.au/content/?id=183>> at 26 March 2008.

The lack of empirical evidence about what is really happening in the sector means that regulators must operate largely on the basis of anecdotal information and guesswork. Since the time of Adam Smith regulation has been regarded as an undesirable phenomenon, a costly and unwelcome intrusion into the optimal function of free markets. The watchword for regulators has been one of caution and restraint, as they are admonished to tread carefully in order to avoid damaging the viability of a commercial sector. The regulation of franchising is an example of this, but such attitudes about regulation overlook the importance of regulation in establishing competitiveness. They also fail to recognize that current theories of regulation have evolved to encompass a broader conception of what is involved in regulating. The conception includes more diverse actors, a wider range of regulatory instruments, and recognition of all the levels, or layers, at which they operate.

The seminar at Macquarie University Faculty of Law in October 2007 dealt primarily with the reasons why disclosure fails to address the problems of the franchising sector, specifically why it fails to achieve its stated objectives of redressing imbalance of power and uncertainty for franchisees.⁴ That seminar serves as a point of departure for this short article, which addresses the larger issue, that the regulation of franchising fails to comport with the ‘new learning’ on regulation and that there is, therefore, a need for a reconception of the regulation of franchising. The old adage ‘If it ain’t broke, don’t fix it,’⁵ does not apply here. The fact is there is no proof that this regulation is effective. Instead review upon review has been undertaken prompted by perennial complaints about abuses in the sector. Each review enumerates ways to improve regulation, but such recommendations are usually only agreed to in part or ‘in principle’ by the government and very little actually happens – until the next review. Those who proclaim long and loud that ‘it ain’t broke’ are the people who have the ear of the regulator, which itself has a vested interest in the ‘ain’t broke’ point of view; it is human nature to find people who will tell us what we want to hear. Yet there are many less well-funded and less well-orchestrated voices that persist in the view that the regulation of the franchise sector is inadequate, and that it needs to be fixed.

Because the regulation of the franchise sector has not been proven to be effective, it is worthwhile to consider the ways in which it fails to comport with theories of regulation. This article is arranged in three parts. Part One describes current expanded theories of regulatory process, according to which regulation requires first, democratic, transparent and participative process, and second, a broadened view of regulation as ‘layers of governance.’ These layers encompass regulation not only by statute, such as the Code itself, but also by other public or quasi-public

³ Peter Switzer, ‘Glowing reports on regulation ignore the ugly truth’, *The Australian*, 28 November 2006.

⁴ The specific problems with the use of disclosure and mediation and recommendations for improving their function can be found in the author’s submissions to the Western Australia and South Australia Parliamentary inquiries into the regulation of the franchising sector.

⁵ Fred Shapiro (ed), *The Yale Book of Quotations* (2006) 441.

layers of regulation, such as the courts, as well as private layers of regulation, such as market and contract. Part Two provides an overview of the nature of the franchise sector, and describes how the sector is regulated with respect to these layers of governance, including the regulation of the sector in the traditional sense, as government intervention in the form of the Franchising Code of Conduct as one part of this broader conception of a multi-layered system of governance. Part Three recommends a reframing of regulatory process to ensure the participation of all stakeholders and to encompass the many layers of governance that operate within and impact upon the sector.

I CHANGING CONCEPTIONS OF REGULATION

Disillusionment with the burden and inefficiencies of substantive regulation has stimulated the development of new approaches, a ‘new learning’ about regulation.⁶ Theoretical approaches to regulation have evolved from interest-based to process-based to systems-based approaches that encompass a wide range of organizational structures and inputs. Systems approaches represent a ‘reconception’ of regulation because they rely more heavily on principles of self-regulation, reflexion and responsiveness than traditional approaches. They are also more inclusive, stressing the importance of two aspects of regulation. The first aspect is process that is both participative and democratic; the second is the need to look at regulation as a full range of ‘layers of governance’.

Democratic, Participative Process

Whereas traditional theories of regulation centred on whose interests prevailed in the regulatory process, current theories of regulation have shifted in focus from interests and outcomes to process. Criticisms of substantive regulation have created an impetus for the development of self-regulatory mechanisms that are more reflexive and responsive. Adapted from biology and based on communications and organizational principles, ‘systems’ theory is centred around communications and organizational principles, feedback and responsiveness.⁷ 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.⁸ Feedback within the system is critical to enable regulation to be responsive and adaptable.⁹ Consultation

⁶ Iain Ramsay, ‘Regulatory Capitalism and the “New Learning” in Regulation’ (2006) 28 *Sydney Law Review* 9.

⁷ Many of these concepts are related to autopoietic theory as applied to law and other social sciences.

⁸ See *Systems Theory*
<http://www.utexas.edu/courses/speclass/courses/350/notes/syste350.html>
 at 17 October 2005.

⁹ 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

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’.¹⁰

The concept of ‘self-regulation’, also derived conceptually from the biological sciences,¹¹ is now used generically to refer to any mechanism whereby a subject exercises control over itself to maintain the stability of its function.¹² Self-regulation in business can be defined as ‘internal regulation of the industry by the industry through its own procedures.’¹³ Gunningham and Grabosky write that, ‘[s]elf-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.’¹⁴ 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 financial regulation and many other applications,¹⁵ ‘a venerable tradition in UK [United Kingdom] consumer law, [self-regulation] now the *plat du jour* in studies of regulation and a central focus in the new learning.’¹⁶

Self-regulation is also related to the concept of ‘decentred’ regulation described by Julia Black, among others.¹⁷ Black proposes decentred regulation as an alternative diagnosis for ‘failures’ of state-centred regulation,¹⁸ noting that:

[C]omplexity, fragmentation and construction of knowledge, fragmentation of the exercise of power and control, autonomy, interactions and interdependencies, and the

equifinality’. ‘Equifinality’ is defined to mean the same results with different inputs or processes. See Stephen W Littlejohn, *Theories of Human Communication* (2nd ed, 1983) 32.

¹⁰ See Jacobs & Associates: Regulatory Reform <<http://www.regulatoryreform.com>> at 14 April 2007.

¹¹ ‘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 multiple equilibrium adjustments, by interrelated regulatory mechanisms. See <<http://iit.ches.ua.edu/systems/homeostasis.html>> at 14 April 2007.

¹² 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, ‘Decentring Regulation: Understanding the Role of Regulation and Self Regulation in a “Post-Regulatory” World’ (2001) 54 *Current Legal Problems* 103, 118.

¹³ 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.

¹⁴ *Ibid* 50.

¹⁵ Anthony I Ogus, *Regulation: Legal Form and Economic Theory* (1994) 107.

¹⁶ Ramsay, above n 7.

¹⁷ For a full discussion on the range of meanings of the term, see Black, above n 13.

¹⁸ Julia Black, ‘Critical Reflections on Regulation’ (2002) 27 *Australian Journal of Legal Philosophy* 1, 4.

collapse of the public/private distinction: all are elements of the composite 'decentred understanding' of regulation.¹⁹

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 ...²⁰

Increased levels of participation, particularly at the grassroots, are essential to the process. Cooter and Thomas suggest that centralized law is 'not even plausible for a technologically advanced society.'²¹ They assert that 'efficiency requires that as economies develop, the enforcement of custom in business communities becomes more important as part of the regulation of business.'²²

There are drawbacks, however. 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 private interests: 'with self-regulation, regulatory capture is there from the outset'.²³ 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.²⁴ 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.²⁵ In contrast to direct intervention 'which gets its legitimacy from the democratic process ... self-regulation has to get its legitimacy from somewhere else'.²⁶ There is potential for abuse especially with respect to under-represented interests and the interests of third parties. This potential reinforces the importance of participation in self-regulation, as Vincent-Jones writes:

[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.²⁷

¹⁹ Black, 'Decentring Regulation', above n 13.

²⁰ Ramsay, above n 7.

²¹ Robert D. Cooter and Ulen Thomas, *Law and Economics* (3rd ed, 2000) 1647.

²² Ibid.

²³ Ogus, above n 16, 107–8.

²⁴ Ibid 108.

²⁵ Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy and Practice* (1999) 126.

²⁶ European Consumer Law Group, *From Soft Law and the Consumer Interest*, ECLG/071/2001 <http://ec.europa.eu/consumers/policy/eclg/rep03_en.pdf> at 22 May 2007.

²⁷ Peter Vincent-Jones, 'Contractual Governance: Institutional and Organisational Analysis' (2000) 20 *Oxford Journal Legal Studies* 317, 351.

Layers of Governance

Along with this wider 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. Ogus argues for a wider perspective on self-regulatory alternatives in order to fully tap their potential.²⁸ Wider conceptions of regulation expand the range of potential actors in regulatory processes beyond regulatory activity as the province of watchdog government agencies.²⁹ This, too, represents a sort of 'reconception' of regulation, as it departs from traditional distinctions between private and public regulation.³⁰ More diverse actors are included in the regulatory process along with a greater range of layers, strategies and mechanisms all as part of the regulatory mix.³¹

Under the rubric of regulation is a growing literature that explores and defines these processes, participants, strategies, and tools of regulatory activity. 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.³²

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.³³ Collins' work refers to a 'multi-layered system of governance' of contractual relationships that includes private, non-legal mechanisms of regulation through market interaction; private, non-legal and legal mechanisms of regulation through contract; public or quasi-public governance through court interpretation of contract; and public regulation by statute.³⁴ Each of these layers functions interdependently with the others, and this

²⁸ Ogus, above n 16.

²⁹ 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 Stewart Macaulay and Ian Macneil among others underpins Collins' conception of the contractual framework, the relationship, and the deal.

³⁰ Hugh Collins, *Regulating Contracts* (1999) 358.

³¹ The work of Hugh Collins; Julia Black; Neil Gunningham and Peter Grabosky; Martin Cave; Robert Baldwin, Colin Scott and Christopher Hood; among others, call for the expansion, diversification and improved calibration in the use of regulatory tools.

³² Ramsay, above n 7.

³³ Collins, *Regulating Contracts*, above n 31.

³⁴ Hugh Collins, 'Regulating Contract Law' in Christine Parker, Colin Scott, Nicola Lacey and John Braithwaite (eds), *Regulating Law* (2004) 29. 'Layers of governance' is not a unique term; it is commonly used in reference to the Internet and information systems technology. See <<http://www.capgemini.com/services/soa/governance/>> at 10 July 2007. Collins uses the term 'layers of governance' 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. See also 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.

interaction highlights the connection between private layers of regulation and self-regulation. 'Private regulation' refers to parties' regulation of their own activities through interactions in the market and through the use of private contractual agreements. '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. Each regulatory layer, both private and public, is comprised of a range of instruments, processes and strategies that can be employed to achieve regulatory objectives.

Private regulation is self-regulation, but self-regulation is not always private regulation. 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. Private law does not take the place of public regulation, but its role does take on new significance. In theory private regulation vests control over a commercial relationship in those best equipped to interpret it, the parties themselves. There is a preference for private regulation as more contextualized, sophisticated and efficient than public, substantive, command-and-control regulation,³⁵ but this preference is tempered by the acknowledgement of the value of its function in concert with public regulation.³⁶

With such a variety of means and processes available for any particular regulatory purpose,³⁷ no one instrument or layer of regulation is always the right one. If all layers of governance inform a process of regulation that is participative, democratic and reflexive, then greater legitimacy can be achieved. Within these democratic, participative processes there are choices to be made among levels of regulatory action, instruments, and strategies within each layer. Such choices imply also a need to consider synergies and contra-indications for the various tools and strategies used in regulation.³⁸ Equipped with a more comprehensive perspective of how each layer of regulation works, it should be easier to identify the interactions and synergies and 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. So it is that even a discussion

³⁵ 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'. See John Braithwaite, 'Responsive Regulation for Australia', in Peter Grabosky and John Braithwaite (eds), *Business Regulation and Australia's Future* (1993).

³⁶ Hugh Collins, 'Regulating Contract Law', above n 35.

³⁷ 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.

³⁸ Gunningham, Grabosky and Sinclair, above n 38.

about tools stresses the importance of process. 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.³⁹

Instead of a standard or pyramid, regulatory process encompasses a matrix of tools and strategies, and the relationships among them need not be linear.⁴⁰ Regulation may be voluntary, it may involve self-regulation and it may involve direct intervention or co-regulation or any combination of these approaches. The challenge is to identify the most efficient and effective mix of tools to accommodate the dynamic requirements of any given context, whether that context is environmental regulation, financial services, or the franchising sector.

II GOVERNANCE OF THE FRANCHISE SECTOR

In the face of such disparate views about what is actually happening in the sector, and a lack of reliable information, an important step for regulators seeking to address inefficiencies and imbalances in a sector is to try to understand the existing layers of governance operating within that sector. The following section explains how the governance of the franchising sector is carried out privately, by means of market and contract and through the quasi-public and public mechanisms of the court system and statutory, or direct, intervention. It becomes evident that the franchisee is marginalized at each layer of governance, and, though direct intervention sets a goal to redress this imbalance, the process and choice of tools are poorly suited to achieve this goal.

Private Governance by Means of the Market and Contract

First, at a fundamental private layer of regulation, that of the market, franchisors wield the power. Franchisors and their trade association have the knowledge and experience, but, because their first priority is to ensure that franchisees will want to buy what they have to sell, they do not always provide reliable, accurate information about the sector, as is evidenced by the high proportion of disputes in the sector that involve allegations of misleading or deceptive conduct.

³⁹ Braithwaite, above n 36.

⁴⁰ Neil Gunningham and Darren Sinclair, *Designing Smart Regulation* (1998) Organisation for Economic Co-operation and Development
<<http://www.oecd.org/dataoecd/18/39/33947759.pdf>> at 22 August 2007.

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 engenders doubt 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, because they are, after all, in the business of selling franchises.

Franchisees who try to inform themselves are discouraged by the many obstacles to unified communication, including threats of defamation; risk of breaching antitrust 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. Markets for terms or dispute systems cannot work because franchisees are not aware of the significance of terms and because the dispute system is prescribed by the Code. Negotiation does not work because the franchise contract is not subject to negotiation. And collective knowledge has not worked because of the difficulties in obtaining accurate information about the sector and individual franchise systems and because of the inherent problems in organizing franchisees.

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 they 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 therefore 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. Regulation cannot be expected to be effective if half the sector is marginalized, as the franchisee is marginalized at each layer of governance of the sector – market, contract, the courts and dispute resolution, and direct intervention. Therefore, private governance cannot be regarded as a means to cut costs and to leave the sector to take care of itself.

Public and ‘Quasi-Public’ Regulation by means of the Courts and Direct Intervention

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.⁴¹ Court interpretation of contract involves express and implied terms, using literal and contextual interpretation. The extensive debate over default rules analysis⁴² underscores the uncertainty over the circumstances under which parties’ intentions should be considered insufficiently clear or not to be enforced.⁴³ 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 the contracting parties’ planning purposes.⁴⁴ Extra-contractual duties, such as promissory estoppel, restitution, and duty of care further compound problems of interpretation.⁴⁵ In interpreting contract law the courts may be forced to rely upon the same filtering devices as tort law, for

⁴¹ Collins, *Regulating Contracts*, above n 31, 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. See also Warren Pengilly, ‘Competition Regulation in Australia: A Discussion of a Spider Web and its Weaving’ (2001) 8 *Competition and Consumer Law Journal* 51.

⁴² See Jay M. Feinman, ‘Relational Contract and Default Rules’, (1993) 3 *Southern California Interdisciplinary Law Journal* 43; Omri Ben Shahaar, ‘Agreeing to Disagree: Filling Gaps in Deliberately Incomplete Contracts’, University of Michigan John M. Olin Center for Law and Economics Working Paper Series (2004) Paper 2; George Dent, ‘Lawyers and Trust in Business Alliances’ (2002) 58 *The Business Lawyer* 45.

⁴³ Juliet Kostriksy, ‘When Should Contract Law Supply a Liability Rule or Term: Framing a Principle of Unification for Contracts’, (2000) 32 *Arizona State Law Journal* 1283.

⁴⁴ Collins, *Regulating Contracts*, above n 31, 232.

⁴⁵ See David Charny, ‘Nonlegal Sanctions in Commercial Relationships’ (1990) 104 *Harvard Law Review* 375.

example, proximity, duty, causation, and remoteness, but with these devices come the same problems of subjectivity and indeterminacy.⁴⁶

Hugh 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. There has been inconsistent interpretation of the franchise relationship in the courts in Australia.⁴⁷ Participants in the judicial process 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.

Public regulation, in the form of statutory intervention, also may not have solved the problems in franchising. After thirty years of regulation of the franchise sector in Australia, there is little reliable evidence of the effectiveness of government regulation of the sector. Promulgated in 1998 under section 51AD as part of amendments to the *Trade Practices Act* (the TPA), the current Franchising Code of Conduct ('the Code') was the first mandatory Code of Conduct in Australia.⁴⁸ Officials at the Franchise Council of Australia (the FCA) declare that the Code is effective, yet the Motor Trades Association of Australia (MTAA) has called for the strengthening of the Code.

Pursuant to publicity of disputes between franchisors and franchisees in the Midas, 7-Eleven and Quizno's systems and a CPA Australia report on the impacts of franchisor insolvency on franchisees,⁴⁹ the effectiveness of the Code again became a political issue in 2006, prompting the Government to initiate a Review of Disclosure.⁵⁰ The Government response to this review,⁵¹ however, has not stopped complaints about the sector. In 2007 both the South Australian and Western

⁴⁶ Extra-contractual duties that arise with promissory estoppel, restitution, and tort further compound problems of interpretation of contracts. See Charny, *ibid*.

⁴⁷ Under the Franchising Code of Conduct mediation is the prescribed dispute resolution process in franchising in Australia. The confidentiality of the process makes it difficult to obtain information about how disputes are resolved. Of course, litigation remains an option for the parties.

⁴⁸ The Oil Code (*Trade Practices (Industry Codes – Oilcode) Regulations 2005* (Cth)) is also a mandatory code.

⁴⁹ Jenny Buchan, *When the Franchisor Fails*, Report prepared for CPA Australia by the University of New South Wales, January 2006. See http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-1B0E2A71/cpa/200602_franchisor.pdf > at 31 October 2008.

⁵⁰ The Review of the Disclosure Provisions of the Franchising Code of Conduct, October 2006, See http://www.innovation.gov.au/Section/SmallBusiness/Documents/Franchising_Code_Review_Report_2006_FINAL_06120720070205134250.pdf > at 31 October 2008.

⁵¹ Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct, February 2007, [http://www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_\(Final\)06Feb0720070206091019.pdf](http://www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf) > at 31 October 2008.

Australian State Parliaments undertook their own inquiries into the effectiveness of laws regulating the franchise industry.⁵²

The regulation of the franchise sector in Australia remains the subject of contention and debate. While this paper cannot provide the answer to the question of the effectiveness of regulation, what it does suggest is that the regulation of franchising primarily through an industry Code of Conduct, the provisions of which were borrowed rather than designed for and by the participants, is inconsistent with current concepts of systems theory. It reflects neither the principles of decentred, democratic and participative regulatory process, nor does it reflect recognition of governance that operates at multiple levels.

The regulation of the franchise sector by direct intervention fails essentially on two levels. The first is the failure of regulatory process. 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 and has not systematically identified problems in the sector. It has failed to expand the range of tools available to address problems that are identified; 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 the regulator 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. The procedures used to select the current regulatory measures were inconsistent with best practice in that they involved low levels of consultation, limited evaluation of alternative methods, and the omission of cost-benefit analysis.⁵³ To the extent that there has been any discernable regulatory process, it has lacked full participation and transparency.

While the regulation of the franchise sector has relied upon the involvement of the trade association in its own regulation, the difficulty with this arrangement is that the Code is intended to redress problems in the relationship between franchisors and franchisees, such as imbalance of power and uncertainty. Because the trade association represents primarily franchisors, the regulator's reliance on input from it

⁵² For the reports of these inquiries please see the Inquiry into the Operation of Franchise Businesses in Western Australia (2008) and the Sixty-fifth Report of the Economic and Finance Committee – Franchises, Parliament of South Australia (2008).

⁵³ Fred Anderson, Mary Ann Chirba-Martin, E. Donald Elliott, Ernest Gellhorn, John D. Graham, C. Boyden, Gray, Jeffrey R. Holmstead, Ronald M. Levin, Lars Noah, Katherine Rhyne, and Jonathan Wiener, 'Regulatory Improvement Legislation: Risk Assessment, Cost-Benefit Analysis, and Judicial Review' (2000) 11 *Duke Environmental Law and Policy Forum* 89.

means it is setting guidelines for regulating the relationship with input from only one side of that relationship.

The second level at which the regulation of the franchise sector by direct intervention fails is the failure of substance, of the tools that are employed to achieve the stated objectives of the intervention. 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.⁵⁴ To achieve these objectives, the Franchising Code of Conduct borrowed substantively from United States (US) legislation and was modelled on a style of regulation that is being revised in the United Kingdom (UK). Consisting of several substantive provisions, and disclosure and mediation, the Code relies principally on the latter two self-regulatory tools. In light of the imbalance of power in the relationship, the Code fails to ensure that both sides of the relationship are represented and capable of fulfilling their roles in these self-regulatory procedures.⁵⁵ 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.⁵⁶
 - A franchisor must obtain from the prospective franchisee 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.⁵⁷
 - There can be no general indemnity of franchisor by franchisee.⁵⁸
 - There can be no prohibition on franchisees’ freedom to associate with other franchisees.⁵⁹
 - Procedural provisions are required with respect to transfer and termination.⁶⁰
- Second, there are mandatory dispute resolution procedures.

⁵⁴ Explanatory Memorandum, *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth) No 162
<http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrument1.nsf/frameLodgmenTattachments/77630AD9222B25BCCA256F73000E7654> at 24 August 2005.

⁵⁵ The Franchising Code of Conduct was modelled on the former voluntary code which itself was modelled largely upon US legislation relating to franchising. The original code was voluntary; 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.

⁵⁶ *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth), No 162, Clause 13.

⁵⁷ Ibid Clause 11(2).

⁵⁸ Ibid Clause 16.

⁵⁹ Ibid Clause 15.

⁶⁰ Ibid Clauses 20–23 and Part 4.

- 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. Annexure One of the Code comprehensively details a franchisor's obligations in relation to disclosure.⁶¹

The Code is not only self-regulatory in its reliance on the trade association to inform its substance, but it is also self-regulatory in its choice of tools, such as disclosure and mandatory mediation. These are tools that put the onus on the contracting parties themselves to carry out the regulatory program. Thus the Code reflects trends to self-regulatory solutions, which had been prevalent in regulation despite the fact that capture is a problem with this regulatory formula.⁶² In the UK in recent years there has been a trend away from these trade association codes.⁶³

In Australia, the Franchising Code of Conduct has not been significantly changed

⁶¹ 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 details; 21) Updates; 22) Other relevant disclosure information; 23) Acknowledgment of receipt. The Code is available at <http://www.comlaw.gov.au/ComLawwithLegislation/LegislativeInstrumentCompilation1.nsf/0/4FA9F21A9489DC27CA256F71004E4CCB?OpenDocument> at 30 July 2006.

⁶² 'In the field of consumer policy, the Office of Fair Trading historically favoured informal methods of regulation and its main output during the 1970s and early 80s was codes of practice – a form of self-regulation ... By 1998, 49 trade association codes had been approved ... 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". Ramsay, above n 7.

⁶³ '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 ...' Ramsay notes that the codes project is influenced by Porter's ideas of global competitiveness, where the regulatory agency helps industry achieve higher standards. Ramsay, above n 7.

despite decades of experimentation with the regulation and multiple processes of review. Many recommendations of reviews of the regulation, such as assurances of greater franchisee participation and registration of franchises and disclosure documents, have not been accepted by government. 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. Resources allocated to enforcement are limited.⁶⁴ Currently there are only ad hoc procedures for monitoring, review and evaluation (partly due to lack of funding for these functions, funding that could have come from registration fees). Finally, there is little education or assistance for prospective franchisees, and often little 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.⁶⁵

The Matthews Committee in its 2006 *Review of the Disclosure Provisions of the Franchising Code of Conduct* made a number of recommendations for revisions to the Code.⁶⁶ Some of these were adopted by the Government and the following changes have been in effect since 1 March 2008:

- Removal of the 'one franchise' exemption for franchisors not resident, domiciled or incorporated in Australia with one franchise only in Australia
- Requirement to include a complete copy of the Franchise Agreement with the Disclosure Document to ensure consistency with 'best practice'
- Requirement to include copies of all associated agreements and contracts to be signed by a franchisee with the Disclosure Document at least 14 days before signing
- Disclosure of Section 87B Undertakings not more than 14 days after the undertaking is given
- Disclosure of rebates and other financial benefits
- Auditing of marketing and other cooperative funds
- Information about past Franchises where the franchisee's consent has not been withheld and where that information is available to the franchisor
- Directors of Franchisor to disclose details of proceedings and convictions
- Details and history of the territory or site to be franchised must be provided in a separate document to be supplied to a franchisee with the disclosure document

⁶⁴ Trust is more important when the enforcement budget is low. See Andrew Coulson, *Trust and Contracts: Relationships in Local Government, Health and Public Services* (1998).

⁶⁵ 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.

⁶⁶ Commonwealth *Review of the Disclosure Provisions of the Franchising Code of Conduct* (October 2006) (Matthews Committee), see <http://www.innovation.gov.au/Section/SmallBusiness/Documents/Franchising_Code_Review_Report_2006_FINAL_06120720070205134250.pdf> at 31 October 2008.

- Financial details for the last two financial years including financial reports for any consolidated entity to which the franchisor belongs
- Standardisation of the audit period so that a franchisor must create a disclosure document within 4 months after the end of each financial year
- Disclosure of materially relevant facts within 14 days from the date the franchisor becomes aware of the facts
- Short form disclosure opt out has been removed
- Disclosure document to be given to Franchisees upon extension of the scope or term of a Franchise Agreement
- Copy of the Code to be attached to the disclosure document
- Franchise agreements may not contain and may not require a franchisee to sign any waiver of any verbal or written representation made by the franchisor.

While some of these changes are undoubtedly useful for enhancing protection for prospective franchisees, most commentators and practitioners agree that the majority of the changes are for the most part details and do not constitute major revisions to the regulation. What is perhaps more interesting is the recommendations that were made by the Matthews Committee, many of which had been made by previous reviews of the Code, but were again rejected by the Government, including the following:

- Amending the Code to include a requirement for the franchisor to include a Risk Statement with the disclosure document.
- The Australian Competition and Consumer Commission (ACCC) be tasked with developing a prescribed Risk Statement document with disclosure requirements.
- The ACCC, as part of the registration process, collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.
- The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code. The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement. The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.⁶⁷
- The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the Code. The process would be administered by the ACCC.

⁶⁷ Instead, section 51AC of the Trade Practices Act 1974 was amended to the effect that unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct. The government rejected the recommendation of a risk statement, and stated that these issues were to be covered in educational materials provided by the ACCC.

These significant changes were all rejected by the government. What persists is a regulatory program for franchising in Australia that has taken advantage of the benefits of self-regulatory measures, but has not addressed its disadvantages.⁶⁸ The Code tools are almost entirely self-regulatory and procedural. The two pillars of the regulation, disclosure and mediation, are self-regulatory and procedural tools and even the substantive measures are procedural. The Code is thus self-regulatory both because of the involvement of the trade association in its own regulation as well as in its choice of tools, such as disclosure and mandatory mediation, that rely heavily on the parties themselves to carry out the regulatory program.

Disclosure is not optimal 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. Disclosure puts a heavy burden on a prospective franchisee to be equipped to receive, understand and act upon the disclosed information. It can be effective only if a franchisee is properly positioned to fulfil this role, but a franchisee is neither adequately equipped to play its role in the disclosure process, nor is it a full participant in the broader regulatory process.

Mediation as a regulatory tool falls short for several reasons. One is that, where there is a significant power imbalance between the parties, there is a risk that the stronger participant will dominate the process. The very versatility and flexibility that make the procedure attractive can be used by the stronger party to mould the process to its advantage, so that mediation serves to reinforce existing imbalances in the franchise relationship.⁶⁹ Second, while there is a requirement that mediation be attended in good faith, it can be difficult to enforce. Third, under the current procedures there is insufficient emphasis on preparation for mediation, which disadvantages the less well-informed and less experienced party, usually a franchisee.⁷⁰ Fourth, 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. Fifth, 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. While veterans of franchising in Australia support the mediation procedure outlined in Part Four of

⁶⁸ Ibid.

⁶⁹ A 1992 study that examined franchisors' choice of dispute resolution strategies were 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 challenged the view that integrative problem-solving is more appropriate when levels of complexity are high. See Rajiv Dant and Patrick Schul, 'Conflict Resolution Processes in Contractual Channels of Distribution', (1992) 56(1) *Journal of Marketing* 1 40.

⁷⁰ While the Office of the Mediation Adviser has made some revisions to its policy to allocate a small amount of the mediator's fee to for his or her preparation, this does not ensure adequate preparation of the parties.

the Code as an important step forward since the days when there was no formally recognized mechanism for resolving disputes in the sector, there is potential for further refinements that might benefit all parties. Continued improvement requires ongoing monitoring, evaluation and revision of best practice in handling franchise disputes.

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. Throughout the interactions between franchisor and franchisee, the mechanisms of regulation not only reflect but also often reinforce the imbalance in the relationship in which a franchisee is incapable of fully participating.

III RECONCEIVING REGULATORY PROCESS FOR THE FRANCHISE SECTOR

Drawing upon regulatory theory generally and regulatory practice in other jurisdictions, a 'reconception' of regulation in franchising would rely on principles of self-regulation, reflexion and responsiveness. It would implement process that is both participative and democratic and would encompass the full range of 'layers of governance'. Some ideas are advanced here for reconceiving the regulation of franchising in Australia in order to better align regulatory practice with that suggested by current regulatory theory.

The Use of Tools through all Layers of Governance

The first way that current regulatory practice might better conform to current theoretical ideals of regulatory practice and thus achieve greater effect and legitimacy would be to employ a wider range of tools across all layers of governance. A broader range of tools that could be applied to ameliorate problems in the franchise relationship include collective understanding and negotiation of terms, education to inform markets for terms, better coordination of information available to the public and to the courts, as well as a range of other tools that could be employed in direct intervention. Adjustments to prescribed dispute processes and disclosure can be made that will to some extent enhance the effectiveness of the current regulation. Such adjustments could include changes to specific information and the delivery of that information, education to help franchisees understand disclosed information, and registration to enable monitoring and comparison. Mediation can be rendered more effective through the use of a variety of strategies.

These improvements should be considered, however, only as part of a revised systemic of regulatory process that addresses the call for the expansion, diversification and improved calibration in the use of regulatory tools in which participative process is used to select from a full range of private and public

regulatory instruments.⁷¹ As an alternative to reliance on one or two regulatory tools whose efficacy is unproven, current theories of regulation and formulations of best practice prescribe that regulatory process comprehend the dynamics and interactions among a versatile range of regulatory tools and that it build upon synergies among these tools to achieve regulatory objectives. A full menu of prescriptive, procedural and performance standards can be employed to enhance the regulation of the franchising sector.

Prescriptive standards 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. Prescriptive standards are often specific and can be perceived as being imposed on the sector rather than undertaken voluntarily, so that they may be incompatible with self-regulation, engendering attitudes of 'creative compliance'.⁷²

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. The cooling-off period required at contract formation used in Australia and Malaysia is a procedural regulation, as are the transfer and termination procedures used in Australia and some US states. Dispute resolution procedures include mediation, as required in Australia and Korea.

Performance standards define the regulated interest's responsibility in terms of the goal to be achieved; they include certain requirements of a franchise business before it can sell franchise units; minimum qualifications for franchisors as in Romania; and fiscal solvency requirements before registering franchise offerings as required by the US state of Virginia. A franchise system might be required to operate a certain number of pilot units for a certain number of years before it can sell franchise units as in China and Vietnam. Performance standards for franchising might also include Codes of Ethics and/or Practice as are in place in New Zealand and the European Community.

Democratic Process

Because of the imbalance in the relationship, and the failure of full participation at all layers of governance, self-regulation cannot be relied upon to redress the problems in franchising. Tools are often the focus of efforts to improve regulation, but revision of the regulation of franchising must begin with process. The most important step in revising the regulation of the sector is to ensure that a democratic,

⁷¹ See Collins, *Regulating Contracts*, above n 31; Julia Black, 'Proceduralising Regulation: Part I' (2000) 20 *Oxford Journal of Legal Studies* 597; Gunningham, Grabosky and Sinclair, above n 14; Robert Baldwin, Colin Scott, and Christopher Hood (eds), *A Reader on Regulation* (1998).

⁷² Gunningham, Grabosky and Sinclair, above n 14.

participatory and transparent process is in place to comprehensively assess the needs of the sector and to select, implement and monitor the appropriate regulatory measures. 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. Democratic, participative, collaborative process consistent with the 'new learning' about regulation requires a reframing of the roles not only of a franchisee, but also of franchisors and of the regulator. The responsibility falls to the government to drive the needed change, to ensure a program of efficient and effective regulation that comprehends, acknowledges, and involves the interests of all stakeholders at all stages. It is hoped that the current inquiry into the regulation of franchising, the fourth in three years, may lead to some of these changes.⁷³

CONCLUSION

This article frames the use of disclosure in the regulation of franchising as part of a larger issue, that the regulation of franchising fails to comport with the 'new learning' on regulation. Among the principals of this new learning is the need for transparent, democratic and participative regulatory process that is designed to reflect and encompass multiple layers of governance.

The frequent reviews of the regulation of the sector and continual reports of abuses of power by franchisors are evidence that the current regulation is not understood to be effective. Even the cursory review provided in this article of the governance of the sector at multiple layers is sufficient to flag the major flaw in the regulatory process of the franchising sector. That flaw is that franchisees are denied a voice at every layer of governance. Instead, their subordinate position and lack of a voice is reinforced at every layer of governance.

Reliance on a 'Band-Aid' solution at one layer of governance, that of statutory intervention, places unnecessary limitations on the capacity of regulatory process to respond fully and effectively to the needs of the sector. Current statutory intervention depends on tools that are self-regulatory in nature and require full participation of all the parties to solve the deep systemic problems in a sector, yet it does so in a context where only one party is represented. The imbalance of power and problems of uncertainty for a franchisee that are supposed to be remedied by regulation are not only inadequately addressed, but 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

⁷³ Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Franchising Code of Conduct*, <http://www.aph.gov.au/senate/committee/corporations_ctte/franchising/info.htm> at 31 October 2008.

impairs a franchisee's meagre self-protective capacities in the face of consolidated franchisor power.

The ineffectiveness of both private, self-regulatory measures and public, statutory intervention in addressing the fundamental problems in the sector evidences the need for a reconception of regulatory process in franchising. Yet another review of the Franchising Code of Conduct will not provide the solution. It is time for the regulator and the participants to demonstrate a commitment to process, to not only adjust problems with the detail of regulation, but to fully and comprehensively review the regulation of the franchise sector. 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.'⁷⁴

While regulation of franchising has enlisted the self-referential capacities of institutions, the effectiveness of this approach is compromised by the nature of these institutions, primarily through their failure to establish a role for franchisees. The effectiveness of self-regulation is dependent upon, 'key stakeholders in a market agreeing, preferably on a fully-inclusive basis, to cooperate in such an approach.'⁷⁵ The regulation of the franchise sector is not optimally effective, largely because it fails to involve key stakeholders on a fully-inclusive basis.

⁷⁴ Sanford E. Gaines and Cliona Kimber, 'Redirecting Self-Regulation' (2001) 13 *Journal of Environmental Law* 157, referring to American theorist Eric Orts.

⁷⁵ Olga Borissova (ed), 'Implementation of Regulatory Impact Assessment. Best Practices in Europe' (Seminar Proceedings, American University in Bulgaria, Sofia, August, 2004).