Parliament of Australia

Parliamentary Joint Committee on Corporations and Financial Services

INQUIRY INTO THE FRANCHISING CODE OF CONDUCT

Submission
by

Associate Professor
Frank Zumbo

School of Business Law and Taxation
Australian School of Business
University of New South Wales

October 2008

PROMOTING AN EFFICIENT MARKET FOR FRANCHISES: PROPOSALS FOR GREATER TRANSPARENCY; PROMOTING ETHICAL CONDUCT THROUGH THE *TRADE PRACTICES ACT*; PROMOTING MORE EFFECTIVE DISPUTE RESOLUTION; AND DELIVERING A STRONGER AND MORE PROSPEROUS AUSTRALIAN FRANCHISING SECTOR

This Submission is concerned entirely with promoting an efficient market for franchises in Australia. It is drafted by an independent commentator with nearly 20 years of experience within the Australian franchising sector as a consultant; researcher; regular expert media commentator; as an occasional adviser to members of Federal and State Parliaments; Federal and State Governments and Departments; and the ACCC, as well as being the Australian member of an International Study Group on Franchising convened by the Rome-based international organisation UNIDROIT to draft and finalise a Model Franchise Disclosure Law to reflect world's best practice in franchisor disclosure.

The purpose of this submission is to ensure that the key gaps in the Australian regulatory framework are identified and closed for the benefit of all franchising participants and for the benefit of the Australian franchising sector as a whole. All recommendations are targeted to deal with specific gaps in the regulatory framework and are designed to be a minimum necessary response to close such gaps. In particular, the Submission is focused on proposals to:

(i) Promote greater transparency;
(ii) Promote ethical business conduct through the *Trade Practices Act*; and
(iii) Promote more effective dispute resolution.

The proposals are all pro-franchising and would, if adopted, benefit *all* franchising participants. Indeed, franchising works at its best when *both* franchisors and franchisees benefit from a mutually respectful relationship in which both parties work cooperatively and in good faith towards one another throughout the franchising relationship. This requires that there be full transparency of relevant information that is critical to both parties so as to ensure that the franchising relationship operates as efficiently as possible.

A legal framework that clearly sets out the standards of ethical conduct between the parties is also essential. Such a legal framework should require franchising participants to act in good faith towards one another in all aspects of the franchising relationship. In addition, there needs to be low cost binding dispute resolution processes to build on the good work already being done by mediation. Consideration should be given to establishing a Franchising Industry Ombudsman or Advocate with the ability to identify and deal with emerging trends or problem areas long before they threaten the efficient operation of the market for franchises in Australia. Similarly, consideration

could also be given to establishing a Franchising Expert Determination Scheme.

Finally and given the overlap between an efficient market for franchises and an efficient market for retail leases in Australia, it is important to ensure that the problems creating market failures and inefficiencies in relation to the market for retail leases in Australia are also dealt with. In this regard, I have attached as Appendix I to this Submission my submission to the Productivity Commission's Inquiry into the market for retail tenancy leases in Australia.

All recommendation made in this submission are concerned to promote a more efficient market for franchises by dealing with key issues or problems within the Australian franchising sector. All recommendations are designed to ensure that the respective interests of franchisors and franchisees are carefully balanced in a way that benefits the Australian franchising sector as a whole. Good policy is not about picking particular winners, but should be concerned to ensure that the franchising sector as a whole is the winner. Good franchising means that all franchisors adopt best practice and do so in a fully transparent and ethical manner. Anything less would jeopardize the Australian franchising sector's ability to realize its full potential.

Outline of submission

The submission is divided into the following Parts:

- **List of Recommendations**
- **Part One: Overview of key issues**
- **Part Two: Disclosure - Key gaps and suggested solutions**
- **Part Three: Promoting a greater awareness of the risks and rewards of franchising**
- **Part Four: Promoting ethical business conduct – Closing the gaps in the unconscionable conduct sections of the *Trade Practices Act* and clearly identifying standards of ethical conduct**
- **Part Five : Strategies for enhancing compliance with the Franchising Code; minimising franchising disputes; and promoting world's best practice within the Australian Franchising Sector**

List of Recommendations

(1) **Requiring the franchisor to provide franchisees leasing from the franchisor with a copy of the head lease and any agreement to lease entered into by the franchisor or an associate in relation to that head lease**;

(2) **Identifying mechanisms for seeking to overcome a franchisee's vulnerability under a head lease held by the franchisor where the franchisor fails or default under the head lease;**

(3) **Requiring that the franchisor provide franchisees with full details regarding the amount and size of all rebates and all other financial benefits received directly or indirectly by the franchisor or associate of the franchisor in relation to any goods or services purchased or acquired by franchisees;**

(4) **Requiring the franchisor to provide franchisees with full financial statements of the franchisor and its associates and related companies;**

(5) **Requiring that the franchisor disclose the franchisor's franchising specific experience;**

(6) **Requiring that the franchisor disclose the reasons for the franchisor buying back or taking over a franchise;**

(7) **Requiring the franchisor to provide intending franchisees with a risk checklist;**

(8) **Requiring the franchisor to obtain a written statement from the intending franchisee that the intending franchisee has undertaken or has declined to do an introductory program of franchising education delivered by an Australian Franchising Development Corporation to be established by the Federal Government;**

(9) **Requiring that disclosure documents and franchise agreements and related documents be drafted in plain language;**

(10) **Requiring that franchisees be given notice as soon as the franchisor is placed into administration and to be given timely updates as to the progress of the administration;**

(11) **Prohibiting bullying, intimidation, physical force, coercion or undue harassment within franchise relationships;**

(12) Inserting a statutory definition of the term "unconscionable" into s 51AC of the *Trade Practices Act*;

(13) Inserting a statutory list of examples of the types of conduct that would ordinarily be considered to be "unconscionable" under s 51AC of the *Trade Practices Act*;

(14) Enacting a statutory duty of good faith;

(15) Enacting a new legislative framework within the *Trade Practices Act* to deal with unfair contract terms in franchise agreements;

(16) Amending the *Trade Practices Act* to provide for the imposition of pecuniary penalties for breaches of the Franchising Code;

(17) Amending the *Trade Practices Act* to provide that the Court can issue a class compensation order whereby a Court would, once a breach has been found in an action brought by the ACCC, have the power to compensate affected franchisees without the need for those franchisees to bring their own action or recovery proceedings;

(18) Establishing an Australian Franchising Development Corporation responsible for (i) providing policy leadership and advice on franchising matters to the Federal Government; and (ii) developing and delivering an introductory franchising educational program for all intending franchisees;

(19) Establishing an Office of the Australian Franchising Ombudsman within the Australian Franchising Development Corporation with specific responsibility to (i) research and identify existing and emerging areas of disputation with a view to identifying strategies, mechanism or legal options for minimising such disputes; and (ii) research and identify world's best practice in franchising with a view to promoting and facilitating world's best practice within the Australian franchising sector;

(20) Establishing an Expert Determination Scheme within the Australian Franchising Development Corporation with specific responsibility for finally resolving franchising disputes remaining unresolved following mediation under the Franchising Code; and

(21) Establishing a Franchising Enforcement Unit within the ACCC with sufficient funding to undertake enforcement action for all franchise-related breaches of the *Trade Practices Act* and

Franchising Code; and with a specific mandate to pursue test cases to clarify the operation of the *Trade Practices Act* and Franchising Code, and to identify possible gaps in their application.

Part One: Overview of key issues

From the outset, it would be submitted that this Inquiry provides a valuable opportunity to remedy the gaps in the Matthews' review and the previous Federal Government's response to that review. In short, the terms of reference for the Matthews' review were too narrow and the then Federal Government compounded that error by then failing to do justice to some of the Review's recommendations. The then Federal Government also failed to address some key gaps in the Franchising Code and failures in the operation of the *Trade Practices Act*. Unless those gaps and failures are addressed the market for franchises in Australia will remain inefficient in key aspects and Australia will not have a world's best framework for enabling franchising to reach its full potential in delivering maximum benefits to the Australian economy and consumers.

This Inquiry would be well aware that the Matthews' Review was expressly limited to Part 2 of the Code. That was a mistake. The full Code needed to be reviewed. The narrow terms of reference meant that an opportunity was missed to comprehensively review the Parts of the Franchising Code dealing with dispute resolution and conditions of a franchise agreement. The mistake made by the previous Federal Minister for Small Business to limit the terms of reference should not be repeated. The full code ideally needs to be reviewed every 3 years. The Matthews review was long overdue being about 6-7 years since the last review in 1999/2000 and when it did come it was restricted unnecessarily in its terms of reference. Clearly, this Inquiry represents an extremely important opportunity to bring the Franchising Code up to date and to ensure that it remains relevant to the ongoing needs of the Australian franchising sector.

Most importantly, this Inquiry provides a valuable opportunity to identify remaining gaps in the disclosure requirements under the Franchising Code, as well as existing gaps in the legal framework governing franchising and related relationships. That such gaps exist is beyond doubt. Contrary to the comments of vested interest groups such as the Franchising Council of Australia and the Shopping Centre Council of Australia and their consultants and advisers as represented by groups such as the Trade Practices Committee of the Law Council of Australia, it is clear from the 10 years of experience with the Franchising Code that are critical gaps in the Code's disclosure requirements.

For these vested interest groups to suggest that there are no gaps in relation to the Franchising Code's disclosure requirements is to take a "head in the sand" approach to what is a serious issue. Such a dismissive approach is not only self serving and protective of the vested interests of franchisors and shopping centre owners, but more importantly it fails the franchising sector as a whole. Gaps in disclosure requirements are a problem simply because such gaps create market failures or inefficiencies to the detriment of franchisors, shopping centre owners and franchisees. A lack of transparency leads to inefficient decisions and to higher levels of disputation. If we are aspiring to an

efficient market for franchises and retail space, such markets must be fully informed. Currently, such markets are not fully informed because of the key gaps in the Franchising Code's disclosure requirements, as well as key gaps in the disclosure requirements under State and Territory retail leasing laws.

Of particular relevance to this Inquiry is the ongoing failure for the *Trade Practices Act* and the Franchising Code to provide a clear and comprehensive set of standards of ethical conduct for the guidance of both franchisors and franchisees. Indeed, the very onerous interpretation given by the Courts to the concept of unconscionable conduct under s 51AC has meant that s 51AC has failed to provide an appropriate set of standards of ethical conduct to guide the franchising sector, as well as other sectors.

Once again, we should not let the vested interests of the Franchising Council of Australia and the Shopping Centre Council of Australia and their consultants and advisers as represented by such groups as the Trade Practices Committee of the Law Council of Australia distract us from promoting a more efficient market for franchises and retail space. An efficient market requires that contractual power is not abused in a manner that frustrates the ability of both parties to obtain an economic return on their investment. Of course, franchisors and shopping centre owners are entitled to protect their investment, but so are franchisees and retail tenants. It needs to be remembered that successful franchising, like successful retail leasing, requires that *all* parties are able to enjoy the fruits of the transaction. Unethical conduct may deprive one of the parties of the benefits of the transaction which, in turn, creates market inefficiencies or failures through higher levels of disputation between the parties or an unwillingness by parties to transact with franchisors or shopping centre owners as these players may be seen as unethical or opportunistic. There can be no doubt that the future success of the Australian franchising sector is linked to the community having confidence in the integrity of franchisors and the owners of shopping centres in which many retail franchises will operate.

In short, unethical conduct by unscrupulous franchisors and shopping centre owners discourages future investment in these sectors. It also undermines the value of existing contracts to the franchisee or retail tenant and leads to a windfall gain to the unscrupulous franchisor and shopping centre owner at the expense of the franchisee or retail tenant. Of course, good franchisors and shopping centre owners do not engage in unethical conduct for they recognise that mutual trust, respect and openness are the key ingredients in the mutual success of the franchise or shopping centre. Unfortunately, it is the "bad apples" that create market failures and inefficiencies and that spoil it for the franchising and leasing sector as a whole.

Within this context, the submission is divided into 4 key parts. First, given the long term and mutually dependent relationship between franchisors and franchisees, full and complete transparency is required if the market for franchises is to operate as efficiently as possible and if disputes are to be kept to an absolute minimum. Transparency must work both ways. All matters impacting on the potential viability of the franchise need to be disclosed to the

franchisee or potential franchisee in order for the franchisee or potential franchisee to make an informed decision. Gaps remain in the disclosure requirements under the Franchising Code. Franchisors are still not being required to disclose all matters essential for franchisees to make informed decisions regarding the franchise.

Second, the failure of s 51AC of the *Trade Practices Act* to provide a clear set of standards of ethical conduct and the Courts' very onerous interpretation of the concept of unconscionable conduct has meant that s 51AC has essentially fallen into disuse, except for the most extreme forms unethical conduct. This has meant that there is an urgent need to resuscitate s 51AC or enact alternative legislative frameworks for setting out standards of ethical conduct. Central to these alternative legislative frameworks are the enactment of a statutory duty of good faith and laws to deal with unfair contracts terms in franchise agreements modelled on such laws operating in the United Kingdom and Victoria in relation to unfair terms in consumer contracts.

Third, the current approach to franchising dispute resolution needs to be reviewed. While mediation within a franchising context may be effective in upwards of 70% of cases, there is still a significant percentage of franchising disputes that require other dispute resolution processes. With court action potentially being very expensive and time consuming (and maybe even out of reach), it may be appropriate to explore alternative binding dispute resolution processes such as a Franchising Expert Determination Scheme.

Finally, the issue has recently arisen as to the importance of providing a mechanism that ensures that franchisors fully comply with the terms and obligations of the Franchising Code. Currently, there is no pecuniary penalty for failing to comply with the Franchising Code. With the recent litigation in the Ketchell matter, it is clear that there is non-compliance with key elements of the Franchising Code. Given that current remedies for breaches of the Franchising Code are restricted to injunctions, damages and other orders which, for example, include varying the franchise agreement, it is clear that many breaches of the Franchising Code will lack an effective remedy. Indeed, an excellent example is provided by the Ketchell case where the breach of the Franchising Code involved a failure of the franchisor to seek a signed statement from the franchisee that the franchisee had received appropriate advice before entering the franchise agreement. In such cases, the franchisee is effectively left with no meaningful remedy as an injunction, damages or even a possible variation of the franchise agreement would not in the circumstances provide the franchisee with any meaningful recourse for what is still a breach of the Franchising Code.

Part Two: Disclosure - Key gaps and suggested solutions

Turning to the area of disclosure a number of areas need to be addressed in the interests of greater transparency and correcting information asymmetries that persist within a franchising context. The recommendations made in this part of the submission are highly targeted in dealing with specific gaps that have been identified in the current disclosure requirements.

It is critical that the disclosure requirements are regularly reviewed to ensure that they are still appropriate and, more importantly, to ensure that any gaps that are exposed over time are closed as soon as possible. Indeed, a failure to close such gaps carries the real risk that the effectiveness of disclosure in promoting more efficient outcomes within the franchising relationship is undermined.

The issue is not about “more” disclosure for the sake of disclosure, but rather it is about more “effective” disclosure that seeks to redress current information asymmetries in an efficient and targeted manner. Significantly, this part of the submission reveals that information asymmetries continue to exist within franchising relationships in a manner that continues to produce inefficient outcomes within that relationship.

Finally, and more importantly, the Franchising Code should be a “living and breathing” statement of best practice within the franchising sector. It *should* and *must* evolve where appropriate. Those commentators that suggest that all is well with the disclosure requirements in the Franchising are unfortunately not only failing to acknowledge clear gaps in those requirements, but are more fundamentally failing to acknowledge that those disclosure requirements need to evolve where appropriate to remain relevant to all franchising participants.

Franchising as a business model is evolving and so to must the disclosure requirements evolve where appropriate to meet the continuing needs of all franchising participants. This may require that the disclosure requirements be added to as recommended in this part of the submission, but it may also mean that some Franchising Code requirements are modified over time if repetitive or the objectives of the disclosure can be more efficiently delivered, for example, through plain language drafting of franchise agreements or industry-accepted model contract terms in franchise agreements.

Importantly, we should not let the vested interests of opportunistic franchisors and their legal advisers and consultants to stand in the way of delivering the most efficient policy outcomes for the benefit of the Australian franchising sector as a whole. The Committee is well placed to deliver the most efficient policy outcome for the benefit of *all* franchising participants. After all, the promotion of transparency and openness between the franchisor and its franchisees is the hallmark of a successful franchise. A good franchisor would always be fully transparent and open with its franchisees as a successful franchise relationship is based on mutual trust, respect and openness. The

recommendations in this submission are made with the purpose of promoting best practice across the whole franchising sector.

Disclosure – Requiring that franchisors to provide franchisees leasing from the franchisor with a copy of the head lease and any agreement to lease entered into by the franchisor or an associate in relation to that head lease

While there is a requirement under Clause 14 of the Code for a franchisor to provide a franchisee a copy of lease that the franchisee or a party related to the franchisee is required to sign, this requirement falls short, however, of requiring disclosure in every instance of a head lease or agreement to lease entered into by the franchisor or an associate of the franchisor in relation to the site. It also falls short of requiring pre-contractual disclosure of a head lease or agreement to lease entered into by the franchisor or an associate of the franchisor in relation to the site.

The head lease and agreement to lease entered into by franchisor may affect the viability or operation of the site, particularly if the franchisor is not passing onto the franchisee any fit-out contribution or other lease incentives received by the franchisor or franchisor's associate when taking the head lease over the premises. In the interests of transparency the franchisor should, in addition to providing the franchisee with a copy of the sub-lease or any agreement to sub-lease signed by the franchisee, be required to also provide the franchisee at the pre-contractual stage a copy of the franchisor's or associate's head lease, as well as providing the franchisee with a copy of any agreement to lease that the franchisor or associate has entered into with the landlord in relation to the head lease for the site.

Providing franchisees with a copy of the head lease or agreement to lease in relation to the head lease where a franchisee leases from the franchisor or its associates is essential to providing full transparency of any lease incentives paid to the franchisor or its associates in relation to the head lease. As the franchisee is operating the site to which the lease incentives relate, the franchisee should have the benefit of such lease incentives, especially given that the non-receipt of such lease incentives by the franchisee may impact on the financial viability of the franchised business operated on the premises. Indeed, as the provision of lease incentives by the landlord may effectively lower the rent paid on the premises, a franchisee not receiving the lease incentives may be paying a higher effective rent, thereby placing them at a competitive disadvantage.

Providing franchisees with a copy of the head lease or agreements to lease in relation to the head lease is also essential given that a franchisee leasing through a franchisor holding the head lease is vulnerable if the franchisor or its associate defaults under the head lease. Given that a franchisor's default on the head lease can mean that the franchisee is locked out of the premises and lose their livelihood, the franchisee has a clear interest in the operation of the head lease. This is particularly so given that the effective term of the

franchise is ultimately determined by the length of the head lease. For example, a franchisee needs to be assured that, if it is granted a ten year franchise under the franchise agreement in relation to a particular site, the head lease runs for at least that period of time. Having access to a copy of the head lease may also be of some practical assistance in the event if the franchisor or its associate defaults on the head lease.

RECOMMENDATION

A new Item 18(3) could be inserted in the Disclosure Document requiring that the franchisor provide a franchisee with a copy of the franchisor's or associate's head lease over the premises and any agreement to lease in relation to the head lease over the premises.

ADD-

18.3 A copy of the franchisor's or associate's head lease over the premises and any agreement to lease in relation to the head lease over the premises must be provided to the franchisee:

(a) at least 14 days before the day on which the franchise agreement is signed, if they are available at that time; or

(b) if they are not available at that time — when they become available.

Identifying mechanisms for seeking to overcome a franchisee's vulnerability under a head lease held by the franchisor where the franchisor fails or default under the head lease

In the event that the franchisor holds the head lease and it subsequently fails or defaults under the head lease, the franchisee is totally vulnerable. The franchisee may be locked out of the premises with no standing under the head lease. The franchisee is completely at the mercy of the landlord. Consideration may need to be given to providing a mechanism under which the franchisee has some opportunity to take over the rights and responsibilities under the head lease for the duration of that head lease. After all, the franchisee's business may be financially viable and quite capable of continuing to trade despite the franchisor's failure or default under the head lease.

In relation to the vulnerability of a franchisee where the franchisor holds the head lease, the South Australian Parliamentary Committee forwarded the following question on notice:

> *"Do you support a suggestion that franchisee's should be noted as an 'interested body' on the head lease between the shopping centre management and franchisor, thus ensuring that they receive a copy of all discussions/negotiations between these bodies so as to ensure they are aware of the full conditions of the lease".*

In reply, I supported the suggestion, but with one proviso and that relates to the view that while the noting of the franchisee as an interested body on the head lease may enable the franchisee to receive notice of the full conditions of the head lease, this would be only helpful once the franchisee has entered into the franchise agreement or related agreements to occupy the site. To this extent the suggestion would be a step forward once the franchisee has entered the franchise agreement or related agreements to occupy the site, but could fall short of addressing the need for the pre-contractual disclosure of the head lease and any agreement to lease in relation to the head lease held by the franchisor.

Indeed, the potential franchisee should be given a copy of a head lease and agreement to lease in relation to the head lease held by the franchisor *before* the potential franchisee enters the franchise or related agreements. This need for the pre-contractual disclosure of the head lease or agreement to lease in relation to the head lease is discussed above and would enable the potential franchisee to have a complete picture of the financial viability of operating the franchised business from the premises.

Disclosure – Requiring franchisors to provide franchisees with full details regarding the amount and size of all rebates and all other financial benefits received directly or indirectly by the franchisor or associate of the franchisor in relation to any goods or services purchased or acquired by franchisees

Disclosing merely that rebates or financial benefits are received by the franchisor or its associates is not enough. Full disclosure of the amounts of such rebates is essential as they may impact on the financial viability of the franchised business. As rebates need to be funded in some way, the providers of goods or services to franchisees may inflate the price of goods or services supplied to franchisees in order to fund the rebates or the other financial benefits paid directly or indirectly to the franchisor or its associates. Such inflated prices may place the franchisee at a competitive disadvantage in the market place. Inflated prices due to the need to pay rebates or other financial benefits to a franchisor or its associates prevents franchisees from being competitive with their competitors and ultimately jeopardies the franchisees' chances of business success.

Franchisees or potential franchisees need to be able to fully assess how the payment of rebates to the franchisors or its associates impacts on the competitive position of franchisees in the marketplace. As franchisees are ultimately paying for any rebates or other financial benefits paid to the franchisor or its associates, franchisees have a right to know the amount and size of such rebates and financial benefits. Secrecy in this regard represents a serious market failure as franchisees are denied access to a valuable item of information potentially impacting on their financial viability and competitive positioning in the marketplace.

Despite the Matthew's Review specifically recommending that the amount of any rebates be disclosed in the interests of greater transparency (See page 35 of the Matthews Report) and the previous Government purporting to accept this recommendation, the change to the Code in this regard fails to expressly require that the *amount* of rebates be disclosed.

RECOMMENDATION

A new Item 9.1(ja) could be inserted to give effect to the Matthews' recommendation so that the amount and methods of calculation of any rebates paid to the franchisors or its associates are disclosed in the interests of greater transparency. The following is an example of how a new Item 9.1(ja) could be drafted:

[41] Schedule, Annexure 1, paragraph 9.1 (j)

(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, including the name of the business providing the rebate or financial benefit; and

ADD-

(ja) specify the amount and method of calculation of each rebate or financial benefit referred to under paragraph (j); and

(k) whether any rebate or financial benefit referred to under paragraph (j) is shared, directly or indirectly, with franchisees.

Disclosure – Requiring franchisors to provide franchisees with full financial statements of the franchisor and its associates and related companies

The financial viability of both the franchisee and the franchisor is vital to the success of the franchise. A competent franchisor would require detailed information regarding the financial position of a potential franchisee. Similarly, a competent franchisor would keep track of the ongoing financial position of the franchised business. Of course, the financial viability of the franchisee is a key factor in whether or not the individual franchisee succeeds. Likewise, the financial viability of the franchisor is critical to the success of the individual franchisee. More importantly, however, the financial viability of the franchisor is critical to the success of the whole franchise system.

Clearly, the franchisor's financial viability affects all franchisees. In such circumstances, the franchisees have a very direct interest in the financial viability of the franchisor. The franchisor may hold the head lease for the premises. It holds the intellectual property rights for the franchise system. It provides leadership regarding the goods or services to be supplied by the franchisee. A franchisor that is not financial viable jeopardies all these aspects

of the franchisee's business and leaves the franchisee totally stranded in the case of a franchisor's failure.

While the franchisor is in a contractual position to require a franchisee to disclose its financial position to the franchisor, the franchisee is not in the same position to require that the franchisor to disclose its financial position. Given that the financial viability of the franchisor is critical to the success of all franchisees, it would be appropriate that a franchisor be required to provide a potential franchisee and existing franchisees on a yearly basis with audited financial statements for the franchisor. There may also be the need for ongoing disclosure of all materially relevant financial events impacting on the franchisor and its associates as and when those events occur.

Currently, financial reports do not have to be provided where an audit statement is given to the franchisee. Given that a competent franchisor would in any event be preparing financial statements and having them audited as part of good business practice, the cost of requiring franchisors to provide potential and existing franchisee would be minimal, especially if done electronically. The benefits would however be substantial and would no doubt outweigh considerably the nominal costs associated with a franchisor having to provide audited financial statements to potential or existing franchisees.

Potential franchisees will often be investing their life savings in the franchised business and need to be able to make an informed decision about the financial viability of the franchisor before parting with such large sums of money. Similarly, existing franchisees need to be aware of the ongoing financial viability of the franchisor as they may then be able to work together with the franchisor in the event that the franchisor is struggling financially. The harsh reality under the current situation is that franchisees are often the last to find out about a franchisor's financial problems. This lack of transparency, along with the potential costs to franchisees from a franchisor's failure, can only be remedied by requiring the franchisor to provide a full set of audited financial statements to potential and existing franchisees.

RECOMMENDATION

The provision of a full set of audited financial statements can be achieved by simply deleting the exception found in Item 20.3. This exception too easily allows franchisors to avoid providing audited financial statements.

20 Financial details

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.

20.2 Financial reports for each of the last 2 completed financial years that have been prepared by the franchisor in accordance with sections 295 to 297 of the Corporations Law.

DELETE-

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.

Disclosure – Requiring the franchisor to disclose the franchisor's franchising specific experience

While knowledge of a franchisor's general business experience is important to the potential franchisee and is dealt with in Item 3 of the Disclosure document, there is no specific requirement for the franchisor to disclose its franchising-specific experience, qualifications and training. While good and experienced franchisors may provide information about their franchising specific credentials when disclosing their relevant business experience, inexperienced franchisors are not likely to disclose that they lack franchising specific experience, qualifications and training. Such a lack of franchising specific experience, qualifications and training is a critical piece of information for potential franchisees that are likely to be investing considerable sums of money in the franchise and also relying on the franchisor's skills and experience as a franchisor as well as a business person.

In short, franchising-specific experience, qualifications and training or the lack of them are as important, if not more important, than the franchisor's general business experience. While business experience in the area of the franchise is extremely valuable in order for the franchisor to understand and respond to the changes in the market, it cannot be assumed that a good businessperson in a particular area will necessarily also make the person a good franchisor in the area. At the very least, the potential franchisee should have information to make an informed decision as to the franchisor's competence as both a businessperson and a person who has the requisite skills to be a franchisor. This issue could easily be addressed by the insertion of a new Item 3.3 that would require disclosure of the franchising-specific experience of the franchisor or the lack of it and those involved in the franchisor's business operation relating to the franchise. The following is an example of how a proposed new Item 3.3 could be drafted:

AFTER-

3 Business experience

3.1 A summary of the relevant business experience in the last 10 years of each person, other than an executive officer, mentioned in item 2.6.

3.2 A summary of relevant business experience of the franchisor in the last 10 years, including:

(a) length of experience in:

(i) operating a business that is substantially the same as that of the franchise; and

(ii) offering other franchises that are substantially the same as the franchise; and

(b) whether the franchisor has offered franchises for other businesses and, if so:

(i) a description of each such business; and

(ii) for how long the franchisor offered franchises for each such business.

ADD-

3.3 A summary of the franchising-specific experience of the franchisor and of each person mentioned in item 2.6 in the last 10 years, including:

(a) length of experience in operating the franchise; and

(b) whether or not the franchisor has any franchising-specific qualifications and, if so, a description of those qualifications and who has conferred the qualifications; and

(c) whether or not the franchisor has any franchising-specific training and, if so, a description of that training and who has provided the training.

Disclosure – Requiring the franchisor to disclose reasons for franchisor buying back a franchise

While Item 6.4 of the Disclosure document requires the franchisor to disclose the number of each event set out under that Item, there is no requirement to specify the reasons for each of the particular events. For example, under Item 6.4(f) the franchisor is required to list the number of franchised businesses bought back by the franchisor. The franchisor could easily provide the reasons for each franchised business being bought back by the franchisor. This information may be very important to potential franchisees as it may reveal potential problem areas including the possibility that the franchisor is engaging in “churning” whereby the same premises are bought back and then re-franchised. Systemic problems, as well as churning, could be revealed from reasons given for other events listed in Item 6.4 and, as a result, the requirement to provide reasons, where known to the franchisor, would promote greater transparency.

RECOMMENDATION

This issue could easily be addressed by the insertion of a number of words in the existing Item 6.4 that would require the franchisor to provide reasons for

each event under Item 6.4 to the extent that the franchisor is able to do so. The following is an example of how the proposed wording could be drafted:

6 Existing franchises

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 **[ADD – and for each event, the reason or reasons for the event to the extent that the franchisor is able to provide the reason or reasons for the event]**:

(a) the franchise was transferred;

(b) the franchised business ceased to operate;

(c) the franchise agreement was terminated by the franchisor;

(d) the franchise agreement was terminated by the franchisee;

(e) the franchise agreement was not renewed when it expired;

(f) the franchised business was bought back by the franchisor;

(g) the franchise agreement was terminated and the franchised business was acquired by the franchisor.

Part Three: Promoting a greater awareness of the risks and rewards of franchising

The promotion of a greater awareness of the risks and rewards associated with franchising would promote a more efficient market for franchises, as well as minimising the risk of disputation between franchising participants. It is trite to say that not all intending franchisees in a franchise system will make suitable franchisees. Of course, it is also trite to say that not all intending franchisors will make good franchisors. All too often, both intending franchisee and intending franchisors are lured by the appeal of franchising without fully appreciating the risks and rewards of franchising. Yes, franchising is a successful platform for conducting business, but franchising is *not*, in itself, a guarantee of business success. Both franchisors and franchisees do fail and, intending franchisors and franchisees should be fully aware of that before investing in franchising.

Such an awareness of the risks and rewards of franchising can be gained from one's own research, but such information is often of a general nature or not readily obvious or available to the intending franchisor or franchisee. In this regard, franchise specific education is critical and needs to reach the intended audience. On the franchisor side, this role in performed by industry bodies, larger law firms and other service providers. On the franchisee side, however, there is a real challenge in reaching the target audience, namely intending franchisees.

Educating intending franchisee and ensuring that they have access to an acceptable introductory program of franchising education is of fundamental importance requiring a coordinated and holistic approach that hitherto has been missing within the Australian franchising sector. There can be no doubt that the promotion of a greater awareness of the risks and rewards of franchising amongst intending franchisees is essential to the proper and efficient functioning of the market for Australian franchisees.

Within this context, this part of the submission will make the following recommendations:

- **Requiring the franchisor to provide intending franchisees with a risk checklist;**

- **Requiring the franchisor to obtain a written statement from the intending franchisee that the intending franchisee has undertaken or has declined to do an introductory program of franchising education delivered by an Australian Franchising Development Corporation to be established by the Federal Government;**

- **Requiring that disclosure documents and franchise agreements and related documents be drafted in plain language; and**

- **Requiring that franchisees be given notice as soon as the franchisor is placed into administration and to be given timely update as to the progress of the administration.**

Promoting a greater awareness of the risks and rewards of franchising – Requiring the franchisor to provide a risk checklist

While the provision of a risk statement was recommended by the Matthew's Review and rejected by the previous Federal Government, the intention behind that recommendation should be revisited. Indeed, the intention was clearly to enable potential franchisees to better understand the risks involved in franchising. An understanding of the risks involved in franchising would be beneficial for all potential franchisees. While potential franchisees must take responsibility for understanding the risks associated with franchising, they could be assisted considerably if they were provided with a checklist of the types of risks that they should be investigating before entering the franchise agreement.

RECOMMENDATION

Such a risk checklist could quite easily be included under Item 1 of the disclosure document and involve setting out a list of questions that draw the potential franchisee's attention to key risks they need to investigate. All too often, franchisors market their franchises to people that have no previous business experience and such people typically have no idea of the type of questions they need to ask. If franchisors are going to target people with no previous business experience, then franchisors should be assisting those people to understand the risks associated with running the franchised business.

Providing potential franchisees with training on the operation of the franchise system goes only part of the way because the success of the franchised business will depend on many other factors which are unrelated to "following" the system being franchised by the franchisor. If merely following the franchise system is not enough to guarantee business success, then potential franchisees need to be aware of all the factors, both within and external to the franchise system, that contribute to business success. Indeed, if franchisors are representing that no previous business experience is needed, they should have a responsibility to fully equip potential franchisees in understanding the key challenges associated with operating the franchised business and that must necessarily include helping potential franchisee to identify the key risks involved in such a business.

Promoting a greater awareness of the risks and rewards of franchising - Requiring the franchisor to obtain a written statement from the intending franchisee that the intending franchisee has undertaken or has declined to do an introductory program of franchising education delivered by an Australian Franchising Development Corporation to be established by the Federal Government

In view of the risks and rewards associated with franchising it is appropriate that all potential franchisees undertake an introductory program of franchising specific education before entering into a franchise. Such a course should be provided by a proposed government agency to be known as the Australian Franchising Development Corporation and should expose all potential franchisees to the basic legal and business issues involved in franchising. While completion of such an educational program would be voluntary, it would be mandatory for all potential franchisees to be informed of the availability of the program by the franchisor. This balance can be achieved by an appropriate amendment to the Franchising Code.

RECOMMENDATION

The Franchising Code could be amended to require that the franchisor give written notice of educational program to all potential franchisees and to require the franchisor to obtain a written statement that such a course has been completed or the potential franchisee has declined to do the course.

AFTER-

11 Advice before entering into franchise agreement

(2) Before a franchise agreement is entered into, the franchisor must have received from the prospective franchisee:

(a) signed statements, that the prospective franchisee has been given advice about the proposed franchise agreement or franchised business, by any of:

(i) an independent legal adviser;

(ii) an independent business adviser:

(iii) an independent accountant; or

(b) for each kind of statement not received under paragraph (a), a signed statement by the prospective franchisee that the prospective franchisee:

(i) has been given that kind of advice about the proposed franchise agreement or franchised business; or

(ii) has been told that that kind of advice should be sought but has decided not to seek it.

ADD-

(2A) Before a franchise agreement is entered into, the franchisor must have received from the prospective franchisee:

(a) a signed statement that the prospective franchisee has, at least 14 days before the prospective franchisee:

(i) enters into a franchise agreement or an agreement to enter into a franchise agreement; or

(ii) makes a non-refundable payment (whether of money or of other valuable consideration) to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement;

been given written notice about the availability of an introductory program of franchising education offered by the Australian Franchising Development Corporation; and

(b) a signed statement that the prospective franchisee has either satisfactorily completed an introductory program of franchising education offered by the Australian Franchising Development Corporation or has declined to undertake such a course prior to:

(i) entering into a franchise agreement or an agreement to enter into a franchise agreement; or

(ii) making a non-refundable payment (whether of money or of other valuable consideration) to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement.

Consequential amendment:

AFTER-

(3) Subclause (2):

(a) does not apply to the renewal or extension of a franchise agreement with a franchisor; and

(b) does not prevent the franchisor from requiring any or all of the statements mentioned in paragraph (2) (a).

ADD-

(3A) Subclause (2A) does not apply to the renewal or extension of a franchise agreement with a franchisor.

Promoting a greater awareness of the risks and rewards of franchising - Requiring that disclosure documents and franchise agreements and related documents be drafted in plain language

A potential franchisee's understanding of a franchise agreement, related documents and the disclosure document under the Franchising Code would be greatly assisted by such documents being drafted in plain language.

RECOMMENDATION

Requiring that disclosure documents and franchise agreements and related documents be drafted in plain language.

Promoting a greater awareness of the risks and rewards of franchising - Requiring that franchisees be given notice as soon as the franchisor is placed into administration and to be given timely updates as to the progress of the administration

The placing of a franchisor into administration is a traumatic event for both the franchisor and franchisees. The failure of a franchisor leaves a trail of devastation that extends to all franchisees and their families. Typically, the end of the franchisor also means the end of the franchisee's business. While it is possible for individual franchisees to re-emerge, this is typically as a totally new business and with considerably uncertainty and cost to re-emerge. For those franchisees that don't or can't continue, they effectively lose everything.

Franchisor failure raises many issues. First, it demonstrates that not all franchisors are successful. Some franchisors are ill-prepared, poorly capitalised or lack the requisite skills to be a franchisor in the first place. Clearly, while not all individuals are suited to being franchisees, it is equally true that not all franchisors are suited to being franchisors.

Second, franchisor failure creates uncertainty for franchisees as they are generally left in dark regarding the administration. Misinformation and confusion tends to be rife, with opportunistic potential bidders for the failed franchisor business and their equally opportunistic advisers adding to the confusion and uncertainty. While this opportunism by potential bidders and advisers raises question of the ethical standards of those involved, it does reveal the clear vulnerability of franchisees where the franchisor fails.

Third, there is currently no mechanism for ensuring that franchisees get timely, correct and independent information about the franchisor's failure. This can be easily remedied by requiring that the Administrator keep franchisees informed of developments in a timely basis. This should the involve Administrator immediately notifying all franchisees of the Administration, as well as providing and adhering to a timetable for notifying franchisees on a timely basis of all material developments in the Administration.

RECOMMENDATION

Requiring that franchisees be given notice as soon as the franchisor is placed into administration and to be given timely updates as to the progress of the administration.

Part Four: Promoting ethical business conduct – Closing the gaps in the unconscionable conduct sections of the *Trade Practices Act* and clearly identifying standards of ethical conduct

The recommendations made in this part of the submission are intended to address a number of problem areas in relation to s 51AC of the *Trade Practices Act* as well as offering various statutory alternatives to promoting ethical business conduct within a franchising context. Once again, these recommendations are concerned to ensure that contractual power is not abused in a manner that denies the franchisee the benefits of the transaction. In particular, the recommendations are aimed at clarifying key concepts such as unconscionable conduct in a manner that is in keeping with their parliamentary intention. Such statutory clarification is needed in view of the very narrow approach taken by the Courts towards such concepts.

Once again, the focus of the recommendations is to promote the most efficient outcome for the franchising sector as a whole. The recommendations are not about picking winners or protecting the inefficient, but rather are concerned to ensure that unscrupulous franchisors and owners of shopping centres behave in an ethical manner towards their franchisees and retail tenants. Currently, there are allegations of unethical conduct that are not being tested in the Courts simply because the Courts are giving such narrow interpretation of the concept of unconscionable conduct that victims of unethical conduct are being advised that the chances of success in court are virtually non-existent.

In these circumstances, for vested interest groups like the Franchising Council of Australia and the Shopping Centre Council of Australia and their consultants and advisers as represented by groups such as the Trade Practices Committee of the Law Council of Australia to suggest that there is no need to insert a statutory definition of unconscionable conduct is to again take a “head in the sand” approach to what is a serious issue. Once again, such a dismissive approach is not only self serving and protective of the vested interests of franchisors and shopping centre owners, but more importantly it fails the franchising sector as a whole. Unethical conduct by unscrupulous franchisors and owners of shopping centres is a problem simply because such gaps create market failures or inefficiencies to the detriment of franchisors, shopping centre owners and franchisees. Unethical conduct leads to higher levels of disputation. If we are aspiring to have an efficient market for franchises and retail space, such markets must not be characterised by unethical conduct. Currently, such unethical conduct continues to exist because such conduct goes unchallenged as a result of the very narrow judicial interpretation of the concept of unconscionable conduct.

The following recommendations are made in this part of the submission:

- **Prohibiting bullying, intimidation, physical force coercion or undue harassment within franchise relationships;**

- **Inserting a statutory definition of the term "unconscionable" into s 51AC of the *Trade Practices Act*;**

- **Inserting a statutory list of examples of the types of conduct that would ordinarily be considered to be "unconscionable" under s 51AC of the *Trade Practices Act*;**

- **Enacting a statutory duty of good faith; and**

- **Enacting a new legislative framework within the *Trade Practices Act* to deal with unfair contract terms in franchise agreement.**

Prohibiting bullying, intimidation, physical force, coercion or undue harassment within franchise relationships

While of course a franchisor should be entitled to enforce the terms of the franchise agreement, it is equally true that franchisees should be allowed to carry on the franchised business without bullying, intimidation, physical force, coercion or undue harassment from the franchisor. Clearly, there is a line between a franchisor enforcing its legal rights and the franchisor engaging in bullying, intimidation, physical force, coercion or undue harassment of the franchisee.

Prohibiting such conduct is well accepted in consumer transactions. It has long been acknowledged that consumers may be vulnerable to conduct that goes beyond normally acceptable behaviour. This is dealt with under s 60 of the *Trade Practices Act*:

> **TRADE PRACTICES ACT 1974 - SECT 60**
> **Harassment and coercion**
>
> A corporation shall not use physical force or undue harassment or coercion in connection with the supply or possible supply of goods or services to a consumer or the payment for goods or services by a consumer.

Such a provision could easily be modified to apply within a franchising context. After all, franchisees, because of their captive status once they enter a franchise agreement, are similarly vulnerable to conduct that goes beyond normally acceptable behaviour. Significantly, s 60 of the *Trade Practices Act* has been subject to judicial comment in a manner which assists in understanding how a proposal for a prohibition against physical force, coercion or undue harassment could operate within a franchising context.

The following comments regarding the terms “coercion” and “undue harassment” were made by Hill J. in *Australian Competition & Consumer Commission v The Maritime Union of Australia* [2001] FCA 1549 within the context of s 60 of the Trade Practices Act are particularly noteworthy:

> 61 There is an obvious ambiguity which the legislature could easily have solved, either by repeating the word "undue" before each of harassment and coercion or listing the word "coercion" before the words "undue harassment". However, neither course commended itself to Parliament. For my part, I am inclined to the view that undue qualifies only harassment and not coercion.
>
> 62 The word "harassment" in my view connotes conduct which can be less serious than conduct which amounts to coercion. The word "harassment" means in the present context persistent disturbance or torment. In the case of a person employed to recover money owing to others … it can extend to cases where there are frequent unwelcome approaches requesting payment of a debt. However, such unwelcome

approaches would not constitute undue harassment, at least where the demands made are legitimate and reasonably made. On the other hand where the frequency, nature or content of such communications is such that they are calculated to intimidate or demoralise, tire out or exhaust a debtor, rather than merely to convey the demand for recovery, the conduct will constitute undue harassment … Generally it can be said that a person will be harassed by another when the former is troubled repeatedly by the latter. The reasonableness of the conduct will be relevant to whether what is harassment constitutes undue harassment. …

63 "Coercion" on the other hand carries with it the connotation of force or compulsion or threats of force or compulsion negating choice or freedom to act: see *Hodges v Webb* [1920] 2 Ch 70 at 85-7 per Peterson J. A person may be coerced by another to do something or refrain from doing something, that is to say the former is constrained or restrained from doing something or made to do something by force or threat of force or other compulsion. Whether or not repetition is involved in the concept of harassment, and it usually will be, it is not in the concept of coercion.

64 It is clear that the word "undue" suggests that what is done must, having regard to the circumstances in which the conduct occurs, extend beyond that which is acceptable or reasonable. It thus adds, … "*an extra layer of evaluation*". The word "undue", when used in relation to harassment, ensures that conduct which amounts to harassment will only amount to a contravention of the section where what is done goes beyond the normal limits which, in the circumstances, society would regard as acceptable or reasonable and not excessive or disproportionate. It would, however, be somewhat unusual to qualify the concept of coercion with the word undue. If there is such a qualification it would suggest that the policy behind s 60 accepted that some normal level of coercion or force overbearing choice or will was, having regard to the circumstances in which the conduct occurred, acceptable or reasonable in a civilised society and that it was only where that acceptable level of coercion was exceeded so that the coercion became "undue" that coercion was intended to be prohibited. I note that J D Heydon in *Trade Practices Law* (2nd edition at [13.620]) likewise is of the view that undue does not qualify coercion. But if undue does qualify coercion it would not seem to add much to it, whereas I am of the view that qualitatively the word "undue" adds the quality of unreasonableness, unacceptability or lack of proportionality to the general concept of harassment.

RECOMMENDATION

Prohibiting bullying, intimidation, physical force, coercion or undue harassment within franchise relationships.

Inserting a statutory definition of the term "unconscionable" under s 51AC of the *Trade Practices Act*

The insertion of a definition of "unconscionable" in s 51AC of the *Trade Practices Act* would be an obvious way to provide clear statutory guidance as to what is meant by the term as is used in s 51AC.[1] Importantly, the insertion of a statutory definition in s 51AC would send a clear parliamentary signal to the Courts that the concept is not only broader than the equitable concept, but that s 51AC is intended to promote ethical business conduct. Such a definition would set out a non-exhaustive benchmark for assessing conduct to determine whether or not it goes beyond what is reasonably necessary to protect the legitimate interests of the parties involved. This would not in any way interfere with the driving of a "hard" bargain, but rather would provide clear statutory guidance as to what is considered unethical. Currently, in the absence of a statutory definition in 51AC of the term "unconscionable" the Courts are being left to define the term and, in doing so, are taking such an onerous view of what constitutes "unconscionable" that there is a growing danger that s 51AC will fall into disuse.

Growing acknowledgement of the presence of unfair terms in contracts involving small business

The difficulty of bringing action under s 51AC of the *Trade Practices Act* has been recently acknowledged in a number of State Government reports and discussion papers. In each case, the consensus is that s 51AC or equivalent State and Territory provisions is being too onerously interpreted by the Courts and, as a result, there is a need to either reform those provisions or adopt a new approach to unfairness in business to business contracts involving small businesses.

One example of the growing acknowledgement that s 51AC has not been interpreted in keeping with its original parliamentary intention is found in a recent report by the South Australian Parliament into the franchising sector. In its report titled – *Franchises* – the Economic and Finance Committee of the South Australian House of Assembly made the following observations:[2]

> "Section 51AC of the *TPA* was introduced in 1998 to address the problem of small businesses facing power imbalances while dealing with larger commercial entities.[3] It prescribes unconscionable conduct in a specific way and refers to a list of factors that a court may consider in determining whether the conduct in question is unconscionable. This non-exhaustive list of statutory indicators of unconscionable conduct is intended to guide the courts in their application of the provision. The presence of a single factor, such as unequal bargaining power, does not

[1] See Zumbo F., "Commercial Unconscionability and Retail Tenancies: A State and Territory perspective," (2006) *Trade Practices Law Journal*, Vol. 14, p 165 at p. 171 – 172.
[2] The Economic and Finance Committee of the South Australian House of Assembly Report, *Franchises*, May 2008, 42-43.
[3] Philip Tucker, "Unconscionability: The hegemony of the narrow doctrine under the Trade Practices Act" (2003) 11 *Trade Practices Law Journal* 78.

> define the conduct as unconscionable in the absence of some other factor. In the absence of a definition of unconscionable conduct the courts have the power to determine on a case by case basis whether particular action amounts to a breach of the provision.
>
> A narrow doctrine of unconscionability, developed in common law, has been traditionally guided by the assertion that "equity does not expect commercial people to be each others' keepers".[4] It is evident, however, that the meaning of unconscionability under section 51AC is wider than this older, restrictive model. The intention of creating a level playing field for commercial parties of different sizes and bargaining strengths is the underlying theme of the provision. The inclusion of a list of factors in the text of the provision has been interpreted as an indication that unconscionability should be given a broader meaning.[5]
>
> The problem with section 51AC, as put to the Committee, is that the section has not been effective despite its broader remit. The Committee was told that despite the inducements in the provision to consider a wider definition, judicial interpretation of statutory unconscionability has tended to rely on so-called "procedural" aspects of unconscionability, restricting its scope to cases of serious misconduct during the formation and performance of the contract. [6] That approach seems to exclude instances where harsh contractual terms have been inserted in otherwise procedurally valid contracts.[7]
>
> Controversy surrounding the application of the section is provoked by the cautious approach adopted by Australian judges to interpreting it.[8]"

The Report especially identified the omission of a definition of the concept of "unconscionable conduct" as representing a considerable challenge in taking action under s 51AC of the *Trade Practices Act*:

> "The fact the *TPA* does not provide a definition of the term "unconscionable conduct" appears to represent a challenge for the ACCC, the agency responsible for enforcement of the prohibition. While the ACCC is responsible for developing and testing the law in this area, the understanding of the provision remains very limited ten years after its introduction. However, as some witnesses pointed out, the reason for that lack of success may be the original construction of the provision and a lack of guidelines pointing to the intended meaning of the term

---

[4] Ibid 83.
[5] Joachim Dietrich, "The Meaning of Unconscionable Conduct Under the Trade Practices Act 1974" (2001) 9 *Trade Practices Law Journal* 141.
[6] Frank Zumbo, "Promoting Fairer franchise agreements: A way forward?" (2006) 14 *Competition and Consumer Law Journal* 127.
[7] *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) 21 ATPR 41-703.
[8] Liam Brown, "The impact of section 51AC of the Trade Practices Act 1974 (Cth) on commercial certainty" [2004] 20 *Melbourne University Law Review* at <http://www.austlii.edu.au/cgi-bin/sinodisp/au/journals/MULR/2004/20.html?query=impact%20of%20section> at 15 August 2008).

> "unconscionability". Many of those who contributed to the inquiry also stressed that the uncertainty surrounding the meaning of unconscionability makes litigators and lawyers very reluctant to rely on section 51AC as a chosen cause of action. The inability to resort to any other similar provision creates a situation where businesses are denied legal remedies in disputes that often severely impact their interests. In the course of the inquiry perhaps the most high profile example of a franchisee feeling unable to rely on the section was provided by Competitive Foods Australia Pty Ltd (Competitive Foods), whose dispute with Yum! Restaurants International in Western Australia was the subject of discussion and investigation in that State, but it was not an isolated example across the sector."[9]

In view of these concerns and of the considerable evidence put before the Committee, the Report took the position that legislative reform of s 51AC of the *Trade Practices Act* was required:[10]

> "The Committee is of the opinion that section 51AC of the *TPA*, as it currently stands, is not being effectively utilised because of a combination of drafting imprecision and judicial caution. The section has the potential to provide a clear course for redress for franchise disputes and those factors currently obstructing its use should be identified and resolved, even if this requires revisiting the Act. Any such examination of the Act should be done in consultation with the franchising industry, with the needs of franchisees given equal weight with those of franchisor advocates."

> **The Committee recommends section 51AC of the *Trade Practices Act 1974 (Cth)* be amended by the inclusion of a statutory definition of unconscionability or alternatively by the insertion in the Act of a prescribed list of examples of the types of conduct that would ordinarily be considered to be unconscionable.**

In short, the Report provides further recognition of the limitations of s 51AC of the *Trade Practices Act* and, in particular, of how the provision has been narrowly interpreted by the Courts.

A further example of the growing acknowledgement that s 51AC or equivalent provisions are too narrowly interpreted by the Courts or Tribunals is found in a recent discussion paper issued in New South Wales in relation to the retail leasing industry in that State. Indeed, the discussion paper titled - *Issues affecting the retail leasing industry in NSW: Discussion paper – February 2008* – specifically acknowledged the onerous interpretation being given to the New South Wales equivalent to s 51AC. That provision, which is found in s 62B of the *Retail Leases Act 1994*, was described in the following terms in the discussion paper:

---

[9] Ibid 44-45.
[10] Ibid 46.

> "Section 62B sets out a non-exhaustive list of matters to which the Administrative Decisions Tribunal may have regard in assessing whether particular conduct is unconscionable:
> …
> Since 2002, the Administrative Decisions Tribunal has heard 29 cases alleging unconscionable conduct. These authorities indicate that a finding of unconscionable conduct under s 62B can only be made if the conduct can be described as 'highly unethical' and involves 'a high degree of moral obloquy'— s 62B unconscionable conduct will not be found simply because conduct is 'unfair' or 'unjust'.[11] The outcomes of the 29 cases were as follows:
>
> - Unconscionable conduct was found in five cases (however two of these were overturned on appeal on grounds unrelated to the unconscionable conduct claims);
> - One matter was transferred to the Supreme Court;
> - The unconscionable conduct claims were withdrawn in five cases;
> - Unconscionable conduct was held not to be made out in 13 cases;
> - It was held unnecessary to consider the question of unconscionable conduct in six cases.
>
> Analysis of the unconscionable conduct cases heard by the Administrative Decisions Tribunal to date indicates the test is onerous and the threshold for a finding of unconscionable conduct is very high. Because of the narrow interpretation of s 62B in accordance with equitable doctrine, the unconscionable conduct provisions have not operated as intended. There are many instances of unfair conduct on the part of landlords where tenants are unable to avail themselves of the remedy in s 62B due to the onerous test imposed."[12]

Significantly, the discussion paper raised similar concerns with s 51AA of the *Trade Practices Act*:

> "Similar criticisms have been levelled at s 51AA of the *Trade Practices Act 1974* (Cth), which contains specific provisions aimed at providing increased protection where there may be an imbalance of bargaining power between small businesses and their larger business suppliers or customers. This section was introduced in 1992 to extend the unconscionability provisions. The ACCC noted in its submission to the 2007 Productivity Commission inquiry that it had been anticipated these provisions would be of particular use to tenants and franchisees in unequal bargaining positions with their landlords or franchisors. It noted however that s 51AA had not lived up to its expectations in respect of retail leasing matters due to the court's limited interpretation of s 51AA in accordance with equitable doctrine. Despite making enforcement of s

[11] *Attorney General of New South Wales v World Best Holdings Ltd* (2005) 63 NSWLR 557, 583.
[12] *Issues affecting the retail leasing industry in NSW: Discussion paper – February 2008,* 17-18.

> 51AA a priority, the ACCC has been unable to build a single case that would succeed in relation to complaints from retail tenants in shopping centres."[13]

In short, the Courts are taking a narrow approach to the concept of unconscionable conduct and, consequently, it is appropriate that legislature define the term in the legislation to ensure that the concept is interpreted in a manner that promotes ethical conduct by franchisors.

A proposed definition of unconscionable conduct

The following is a draft of a proposed definition of "unconscionable conduct" that could be inserted under the *Trade Practices Act* and in relevant State and Territory legislation:

> "For the purposes of this section "unconscionable conduct" includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.

The proposed definition represents a non-exhaustive definition of unconscionable conduct. Importantly, the use of word "includes" makes it clear that the proposed definition is intended to allow the existing judicial interpretation to be built upon through a statutory mandate that makes it clear that the concept of unconscionable conduct for the purposes of s 51AC of the *Trade Practices Act* is meant to cover all forms of unethical conduct.

In short, the proposed definition is intended to overcome the restrictive view that the Courts are currently taking towards the notion of "unconscionable conduct" under s 51AC. Indeed, in applying the concept of "unconscionable conduct" under s 51AC the Courts are focusing increasingly on procedural unconscionability. In doing so, the Courts continue to be influenced by the narrow equitable doctrine of unconscionability. While perhaps not surprising given the concept of "unconscionable conduct" has been previously used under the equitable doctrine of unconscionability, this procedural unconscionability bias unfortunately raises considerably the threshold for succeeding under s 51AC. Thus, to ensure that the concept of "unconscionable conduct" is given a wider application than is currently the case it would be appropriate to include a legislative definition of the concept of "unconscionable conduct." Such a definition defines "unconscionable conduct" by reference to a variety of other known concepts that make it clear that the term "unconscionable" as used under the proposed provision is one concerned with dealing with unethical conduct within trade or commerce generally.

[13] Ibid 19.

Inserting a statutory list of examples of the types of conduct that would ordinarily be considered to be "unconscionable" under the *Trade Practices Act*

An alternative to inserting a statutory definition of "unconscionable" would be to recast the exiting list of factors under s 51AC(3) and 51AC(4) to represent *examples* of conduct that would ordinarily be considered to be "unconscionable." Currently, the factors can be considered or dismissed at the Court's discretion and as mere factors certainly cannot be seen to define what is unconscionable. In short, It is important to note that the listing of factors in s 51AC(3) and s 51AC(4) does not elevate those factors to a definition of unconscionable conduct. Indeed, it would be misleading to suggest that the factors included in s 51AC(3) or s 51AC(4) provide a definition of what is "unconscionable" under s 51AC. The question of whether or not conduct is unconscionable under s 51AC is considered by reference to the individual circumstances of the case having regard to all matters considered relevant by the Court irrespective of whether or not those matters are listed in s 51AC(3) or s 51AC(4). So under s 51AC(3) and s 51AC(4) the listed factors as currently drafted may be considered by a Court, but so can factors not listed be taken into account if the Court considers them to be relevant.

In such circumstances, recasting the factors into examples of unconscionable conduct would provide considerable and practical statutory guidance as to what is meant by the term "unconscionable." The examples could easily be added to or fine-tuned overtime and, would give all parties a very clear legislative indication of where they would ordinarily stand in relation to particular types of conduct. The following sets out how a statutory list of examples could be drafted:

> "Without in any way limiting the conduct that the Court may find to have contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the ***business consumer***), the following will, in the absence of evidence to contrary, be regarded as unconscionable for the purposes of subsection (1) and (2):
>
> - the supplier used its superior bargaining position in a manner that was materially detrimental to the business consumer; or
> - the supplier required the business consumer to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; or
> - the suppler was aware and took advantage of the business consumer's lack of understanding of any documents relating to the supply or possible supply of the goods or services; or
> - the supplier exerted undue influence or pressure on, or engaged in unfair tactics against, the business consumer or a person acting on behalf of the business consumer; or
> - the supplier's conduct towards the business consumer was significantly inconsistent with the supplier's conduct in similar

transactions between the supplier and other like business consumers; or

- the supplier failed to comply with any relevant requirements or standards of conduct set out in any applicable industry code; or
- the supplier unreasonably failed to disclose to the business consumer:
    - o any intended conduct of the supplier that might affect the interests of the business consumer; or
    - o any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); or
- the supplier was unwilling to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; or
- the supplier exercised a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer for the supply of the goods or services in a manner that was materially detrimental to the business consumer; or
- the supplier acted in bad faith towards the business consumer."

Such a statutory list of examples would be of considerable value in setting out clear statutory benchmarks for the Courts to rely on when assessing conduct under s 51AC. Currently, the Courts are left to their own devices as to the meaning of "unconscionable" under s 51AC and this brings with it the real danger that the Courts will revert to the more narrow equitable notion of unconscionability when assessing conduct under the section. By setting out statutory benchmarks in the section itself the legislature can provide clear direction to the Courts regarding the types of conduct ordinarily considered to be unethical by the legislature. Such benchmarks would seek to steer judicial attention away from the narrow equitable notion of unconscionability and towards having the Courts assess the conduct by reference to the ethical norms set out by the legislature in its statutory list of examples.

Enacting a statutory duty of good faith

While any statutory definition of "unconscionable" could usefully rely on the concept of good faith as a means of ensuring the Courts take a broader approach to s 51AC of the *Trade Practices Act* than their presently onerous and very legalistic approach to the section, an alternative would be to enact a stand alone statutory duty of good faith. Either way, the concept of good faith offers considerable potential as a mechanism for promoting ethical business conduct. Indeed, this is readily apparent from the growing judicial attention and support given to an implied duty of good faith in commercial contracts, especially in New South Wales.[14]

Such a statutory duty of good faith should operate generally within the franchising relationship, including requiring the parties to resolve disputes in good faith. A precedent for requiring the parties to mediate in good faith is found in Clause 45(1) of the Mandatory OilCode which provides:[15]

45 Provision of mediation and assistance

(1) All mediation … provided under this Part must be carried out in good faith.

A convenient summary of the nature and scope of an implied duty of good faith was recently provided by Gordon J in *Jobern Pty Ltd v BreakFree Resorts (Victoria) Pty Ltd*:[16]

> 146 Specific conduct has also been identified by various courts as constituting '*bad faith*' or a lack of '*good faith*' including:
> (1) acting arbitrarily, capriciously, unreasonably or recklessly: e.g. see Viscount Radcliffe in *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415 at 1422-23 cited by Gyles J in *Goldspar* at [173]; and *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65];
> (2) acting in a manner that is oppressive or unfair in its result by, for example, seeking to prevent the performance of the contract or to withhold its benefits: *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65]-[66];
> (3) failing to have reasonable regards to the other party's interests: *Overlook Management BV v Foxtel Management Pty Ltd* (2002) ACR 90–143 at [67] …
> (4) failing to act 'reasonably' in general. …

---

[14] See for example *Renard Constructions (ME) Pty Limited v Minister for Public Works* (1992) 26 NSWLR 234; *Alcatel Australia Limited v Scarcella* [1998] NSWSC 483 (16 July 1998*); Burger King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187: *Overlook v Foxtel* [2002] NSWSC 17 (31 January 2002); and *Vodafone Pacific Ltd & Ors v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004).

[15] *See Trade Practices (Industry Codes - Oilcode) Regulations 2006*

[16] [2007] FCA 1066 (23 July 2007).

> 147 A requirement to act '*reasonably*' when acting in good faith was first articulated in Australia by Priestly JA in *Renard Constructions* where his Honour observed that reasonableness had "*much in common with the notions of good faith"*: at 263. Following this decision, courts have favoured '*reasonableness*' as one of the requirements of good faith. Finkelstein J in *Garry Rogers Motors* stated that *"provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied"*: at [37].

Significantly, Gordon J also outlined apparent judicial consensus as to what is *not* encompassed by a duty of good faith:

> 149 …a duty of good faith:
> (1) is not fiduciary in nature;
> (2) does not require a party to subordinate its own interests, let alone act selflessly; and
> (3) does not require a party to restrict decisions and actions, reasonably taken, which are designed to promote the legitimate interests of a party and which are not otherwise in breach of an express contractual term.

Clearly, the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.

The Matthews' Review recommended that a duty of good faith be incorporated in the Franchising Code (see pages 46 - 47). This recommendation was rejected by the then Federal Government on the basis that "good faith" was factor in s 51AC. Unfortunately, this represents a fundamental misunderstanding by the previous Federal Government of the role played by the factors in s 51AC. As explained above, the factors in s 51AC do not define "unconscionable" conduct but are merely matters that a court may or may not choose to consider in cases under s 51AC. In fact, although an absence of good faith would ordinarily be considered to be unethical, it is entirely possible that an absence of good faith may not in itself be unconscionable under s 51AC. This situation arises simply because of the extreme nature of the conduct required by the courts before they will consider conduct to be "unconscionable" under s 51AC.

A statutory duty of good faith would represent a positive statement of what is considered ethical conduct within a franchising context and provides an appropriate and well accepted benchmark of appropriate standards of ethical behavior. This is particularly relevant in a franchising relationship given the inter-dependency of the franchisor and franchisee. The ongoing success of the relationship requires that they act in a mutually respectful and cooperative manner throughout the course of the relationship. A statutory duty of good faith would set out the boundaries of acceptable conduct in a positive manner for the benefit of both franchisors and franchisees.

Enacting a new legislative framework within the Trade Practices Act to deal with unfair contract terms in franchise agreement

Ensuring greater judicial scrutiny of unfair terms in franchise agreements would go a long way to promoting ethical business conduct. Such judicial scrutiny of unfair contract terms is currently lacking and unfortunately can act as a green light to unethical franchisors intent on including contract terms that go beyond what is reasonably necessary to protecting their legitimate interests. In such circumstances, a new national legislative framework within the *Trade Practices Act* is needed to deal with unfair terms within franchise agreements.[17] Such a framework would help promote greater judicial scrutiny of substantive unconscionability and could be based on the United Kingdom[18] and Victorian[19] legislation for dealing with unfair terms in consumer contracts.[20]

Needless to say, the acceptance of the need for a new legislative framework to deal with unfair contract terms is a vital first step in a process that leads to designing and then implementing such a legislative framework. Clearly, further work needs to be undertaken to give full effect to the growing consensus that Australia needs to implement a world's best practice legislative framework dealing with unfair contract terms. Such a framework should have the following features;

- a clear definition of an unfair term;
- include a comprehensive listing of potentially unfair terms which provides clear statutory guidance to consumers, businesses and the Courts regarding the types of terms considered to be unfair;
- contain an ability to prescribe particular terms or classes of terms as "unfair" so that widespread consumer detriment can be prevented in advance and without the need to separately pursue each individual use of the unfair term or terms;
- impose a penalty for using a prescribed unfair term as a necessary deterrent against the use of terms recognized as being unfair;

---

[17] See Zumbo F., Promoting Fairer Franchise Agreements: A Way Forward?" (2006) *Competition and Consumer Law Journal*, Vol. 14, 127 – 145.

[18] The UK legislation was implemented first and is now found in the *Unfair Terms in Consumer Contracts Regulations 1999*. These Regulations came into force on 1st October 1999.

[19] The Victorian legislation is found in Part 2B of the *Fair Trading Act 1999* and came into force on 9 October 2003.

[20] For a discussion of the operation of the United Kingdom and Victorian legislation see Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" *Trade Practices Law Journal*, Vol. 13, pp. 70 - 89; Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: The search for a new regulatory model," *Trade Practices Law Journal*, Vol. 13, pp. 194 - 213; and Zumbo, F., (2007), "Promoting Fairer Consumer Contracts: Lessons from the United Kingdom and Victoria", *Trade Practices Law Journal*, Vol. 15, pp. 84-95.

- have a well resourced Government enforcement agency to respond to allegedly unfair contracts terms in a timely and pro-active manner to minimize the actual or potential detriment arising from the term;
- provide guidance and education to both businesses and consumers to maximize awareness and understanding of the legislative framework;
- allow for enforceable undertakings to be provided to Government agency to enable matters to be resolved quickly and without recourse to the Courts;
- allow for advisory opinions by Government enforcement agency to enable particular businesses and industries to seek specific guidance in advance of using terms considered at risk of being viewed as unfair;
- allow for advisory opinions by quasi-judicial body to provide businesses or the Government enforcement agency the opportunity to secure a binding opinion as to the whether or not a particular term is unfair; and
- allow for private enforcement of the framework to enable those affected parties to recover any loss or damage arsing from an unfair contract term.

A single legislative framework for dealing with unfair contract terms in relation to consumers and small businesses would play a central role in the promotion of ethical business conduct. [21] Significantly, Senator Stephens on behalf of the Australian Labor Party also made mention of the issue of unfair contracts during the Senate debate on *Trade Practices Legislation Amendment Bill (No. 1)* 2007 by calling on the then Federal Government to "closely examine options for introducing a regime dealing with unfair contract terms between businesses as well as between business and consumers."[22]

[21] Zumbo, F., (2007), "Are Australia's Consumer Laws Fit for Purpose", *Trade Practices Law Journal*, Vol. 15, p. 227, at 232 -236.
[22] See Harsard, Australian Senate, 17 September 2007, at 2.

Part Five: Strategies for enhancing compliance with the Franchising Code; minimising franchising disputes and promoting world's best practice within the Australian Franchising Sector

There can be no doubt that the success of the Australian franchising sector is tied to the implementation of strategies for (i) enhancing compliance with the Franchising Code; (ii) minimising franchising disputes; and (iii) promoting world's best practice within the Australian franchising sector. In this regard, the following recommendations are made in this part of the submission:

- **Amending the *Trade Practices Act* to provide for the imposition of pecuniary penalties for breaches of the Franchising Code;**

- **Amending the *Trade Practices Act* to provide that the Court can issue a class compensation order whereby a Court would, once a breach has been found in an action brought by the ACCC, have the power to compensate affected franchisees without the need for those franchisees to bring their own action or recovery proceedings;**

- **Establishing an Australian Franchising Development Corporation responsible for (i) providing policy leadership and advice on franchising matters to the Federal Government; and (ii) developing and delivering an introductory franchising educational program for all intending franchisees;**

- **Establishing an Office of the Franchising Ombudsman within the Australian Franchising Development Corporation with specific responsibility to (i) research and identify existing and emerging areas of disputation with a view to identifying strategies, mechanism or legal options for minimising such disputes; and (ii) research and identify world's best practice in franchising with a view to promoting and facilitating world's best practice within the Australian franchising sector;**

- **Establishing an Expert Determination Scheme within the Australian Franchising Development Corporation with specific responsibility for finally resolving franchising disputes remaining unresolved following mediation under the Franchising Code; and**

- **Establishing a Franchising Enforcement Unit within the ACCC with sufficient funding to undertake enforcement action for all franchise-related breaches of the *Trade Practices Act* and Franchising Code; and with a specific mandate to pursue test**

cases to clarify the operation and to identify possible gaps in the application of the *Trade Practices Act* and Franchising Code.

Amending the *Trade Practices Act* to provide for the imposition of pecuniary penalties for breaches of the Franchising Code

As a result of the recent litigation in the Ketchell matter, it is clear that there is non-compliance with key elements of the Franchising Code. More dangerously, it is also clear that the non-compliance with the Franchising Code requirements in the Ketchell matter is not an isolated example of such non-compliance. The Franchise Council of Australia itself reportedly made the following comments to explain its interest in pursuing the Ketchell matter all the way to High Court:

> "The NSW Court of Appeal held in Ketchell's case that where a franchisor does not have a written acknowledgement that a franchisee has received, read and had an opportunity to understand the disclosure document, the franchise agreement is unlawful and unenforceable.
>
> The Franchise Council of Australia, the industry's peak body, says this amounts to rendering a franchise agreement illegal for a technical breach of the code – and it is a decision that could create great uncertainty for 10% of franchise agreements or 5000 franchisees and their franchisors."[23]

While it is of concern that there is any non-compliance with the Franchising Code requirements, it is of particular concern where a breach of the Franchising Code is described as a "technical" breach. The obvious connotation is that there are minor breaches that we should not be worried about. If franchisors and their advisers or industry association start taking the view that some breaches are "technical" or "minor," then unscrupulous or opportunistic franchisors will start ignoring or being dismissive of Franchising Code requirements that are subjectively viewed as "technical" or "minor." A failure to comply with a requirement of the Franchising Code is a breach of the Code and each breach undermines the effectiveness of the Franchising Code. Unless, there is an appropriate deterrent to prevent breaches of the Franchising Code, it is clear that aspects of the Code may simply be ignored by unscrupulous or opportunistic franchisors as there may not be an effective remedy for franchisees to pursue.

Given that current remedies for breaches of the Franchising Code are restricted to injunctions, damages and other orders which, for example, include varying the franchise agreement, it is clear that many breaches of the Franchising Code will lack an effective remedy. Indeed, an excellent example of this situation is provided by the Ketchell case where the breach of the Franchising Code involved a failure of the franchisor to seek a signed statement from the franchisee that the franchisee had received appropriate

---

[23] See article by Jacqui Walker "Franchise Council likely to fund Ketchell case alone" Friday, 29 February 2008 which can be accessed at: http://www.smartcompany.com.au/Free-Articles/The-Briefing/20080229-Franchise-Council-likely-to-fund-Ketchell-case-for-franchise-industry-alone.html

advice before entering the franchise agreement. While the obtaining of this written statement from potential franchisees is seen as very important to ensuring that *both* franchisors and potential franchisees appreciate the importance of the potential franchisee seeking appropriate advice *before* entering into the franchise, it is clear that not all franchisors are seeking such a written statement from potential franchisees. Not only is this poor practice on the part the franchisor, but it is a breach of the Franchising Code. More importantly, the franchisee is effectively left with no meaningful remedy as an injunction, damages or even a possible variation of the franchise agreement would not in the circumstances provide the franchisee with any meaningful recourse for what is still a breach of the Franchising Code.

RECOMMENDATION

The *Trade Practices Act* should be amended to provide for the imposition of a pecuniary penalty for failing to comply with the Franchising Code.

Class compensation order - Amending the *Trade Practices Act* to provide that the Court can issue a class compensation order whereby a Court would, once a breach has been found in an action brought by the ACCC, have the power to compensate affected franchisees without the need for those franchisees to bring their own action or recovery proceedings

A key challenge faced by franchisees relates to their current inability to recover losses from breaches of the *Trade Practices Act* in a timely and cost-effective manner. All too often agencies like the ACCC can successfully prosecute breaches of the *Trade Practices Act*, but franchisees affected by the conduct find it to difficult to cost-effectively recover their losses. Within this context, it is appropriate to consider a new approach to efficiently and effectively facilitating the recovery of losses from breaches of the *Trade Practices Act*, including breaches of the Mandatory Franchising Code of Conduct and misleading or deceptive conduct as well as unconscionable conduct. Such an approach could involve giving the Courts the power to make a "class compensation order" whereby the Court would, following a finding that there has been a breach of the *Trade Practices Act*, order the franchisor to compensate all affected franchisees notifying a court-appointed assessor of their loss or other claim within a specified period of time.

Under a class compensation order, the Court would have the power to compensate affected franchisees without the need for those franchisees to bring their own action or recovery proceedings. In particular, a class compensation order would, once a breach has been found in an action brought by the ACCC, allow the Court itself to set up a framework:

(i) to ensure that affected franchisees are notified within a reasonable period of time that they are able to make a claim to the particular Court in relation to the contravening conduct;
(ii) allowing a reasonable period of time for affected franchisees to lodge their claim;
(iii) appointing an assessor, answerable to the Court, to review all claims lodged by affected franchisees within the specified time; and,
(iv) for the Court to finally approve any claim recommended by the assessor.

This process would be funded by the contravening party and would provide a streamlined process for dealing with individual claims arising from a proven breach. While there would be judicial oversight of the process, the Court itself would not be tied down by having to consider the factual background of each affected franchisee. Indeed, any factual assessment of individual claims can easily be undertaken by an assessor or assessors, who could conduct such assessments in a very efficient and cost effective manner without the need to take up valuable court time.

Thus, a class compensation order would not only enable franchisees affected by the contravening conduct to recover their losses in a streamlined manner,

but such an order would be an excellent way to avoid courts being clogged up by a proliferation of individual recovery actions which may occur at present. Importantly, a class compensation order would allow the Courts to respond flexibly and effectively to cases where a large number of franchisees are affected by the contravening conduct and, in this regard, the availability of a class compensation order would enable the ACCC to play a leadership role in targeting conduct that has a wide-ranging detrimental impact on franchisees or other affected parties.

My proposal for a “class compensation order” was considered on page 236 of an article published last year titled "Are Australia's consumer laws fit for purpose," (*Trade Practices Law Journal*, Vol. 15, p. 227). A copy of the article has been provided in Appendix 6 of this Submission.

RECOMMENDATION

Amending the Trade Practices Act to provide that the Court can issue a class compensation order whereby a Court would, once a breach has been found in an action brought by the ACCC, have the power to compensate affected franchisees without the need for those franchisees to bring their own action or recovery proceedings.

Establishing an Australian Franchising Development Corporation responsible for (i) providing policy leadership and advice on franchising matters to the Federal Government; and (ii) developing and delivering an introductory franchising educational program for all intending franchisees

In view of the importance of a successful franchising sector to the Australian economy, it is vital that there is sufficient and appropriate Government policy leadership with respect to franchising. The size of the franchising sector is such to now justify a stand alone and well resourced Government agency. Such an agency can be modelled on the Western Australian Small Business Development Corporation.[24] This WA Government agency has responsibility for providing policy advice on small business matters in Western Australia. Such a model could quite easily be adopted in relation to franchising with the agency possibly being called the Australian Franchising Development Corporation.

The Australian Franchising Development Corporation would be in a position to provide policy advice to the Federal Minister, as well as developing educational programs, including an introductory franchising-specific education program for all intending franchisees to undertake on a voluntary basis.

RECOMMENDATION

Establishing an Australian Franchising Development Corporation responsible for (i) providing policy leadership and advice on franchising matters to the Federal Government; and (ii) developing and delivering an introductory franchising educational program for all intending franchisees

[24] See http://www.sbdc.com.au/

Establishing an Office of the Australian Franchising Ombudsman within the Australian Franchising Development Corporation with specific responsibility to (i) research and identify existing and emerging areas of disputation with a view to identifying strategies, mechanism or legal options for minimising such disputes; and (ii) research and identify world's best practice in franchising with a view to promoting and facilitating world's best practice within the Australian franchising sector

A new Government agency to be called the Australian Franchising Development Corporation could also provide a home for a new Office of the Australian Franchising Ombudsman. Establishing an Office of the Australian Franchising Ombudsman would ensure that there was a suitable qualified person with specific responsibility to (i) research and identify existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) research and identify world's best practice in franchising with a view to promoting and facilitating world's best practice within the Australian franchising sector.

In effect the Australian franchising Ombudsman would be a "trouble shooter" who systematically searches for new and emerging areas of disputation in the Australian franchising sector with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.

The Ombudsman would also be very well placed to identify world's best practice in franchising with a view to promoting and facilitating its adoption within the Australian franchising sector.

RECOMMENDATION

Establishing an Office of the Australian Franchising Ombudsman within the Australian Franchising Development Corporation with specific responsibility to (i) research and identify existing and emerging areas of disputation with a view to identifying strategies, mechanism or legal options for minimising such disputes; and (ii) research and identify world's best practice in franchising with a view to promoting and facilitating world's best practice within the Australian franchising sector

Establishing an Expert Determination Scheme within the Australian Franchising Development Corporation with specific responsibility for finally resolving franchising disputes remaining unresolved following mediation under the Franchising Code

A new Government agency to be called the Australian Franchising Development Corporation could also provide a home for an expert determination scheme which could operate as a mechanism for resolving disputes that remain unresolved following mediation. Currently, with around 70% of disputes being resolved following the appointment of a mediator by the existing Office of the Mediation Adviser, it is clear that a significant percentage of franchising disputes are not resolved through mediation.

Within this context, an expert determination scheme would be very useful in making available to all franchising participants a suitably qualified person who would be available to make an expert determination regarding unresolved matters involved in the dispute with a view to finally resolving those matters in an efficient, cost effective and mutually beneficial manner.

RECOMMENDATION

Establishing an Expert Determination Scheme within the Australian Franchising Development Corporation with specific responsibility for finally resolving franchising disputes remaining unresolved following mediation under the Franchising Code

Establishing a Franchising Enforcement Unit within the ACCC with sufficient funding to undertake enforcement action for all franchise-related breaches of the *Trade Practices Act* and Franchising Code; and with a specific mandate to pursue test cases to clarify the operation of the *Trade Practices Act* and Franchising Code, and to identify possible gaps in their application.

As the agency having responsibility for enforcing the Franchising Code, the ACCC has a duty to pursue to test cases to clarify the operation of the *Trade Practices Act* and Franchising Code, and to identify possible gaps in their application. This requires that the ACCC be given sufficient and specific funding for such activities and that the ACCC have sufficient and specific internal focus on franchising matters. In this regard, it would be appropriate for there to be a dedicated Franchising Enforcement Unit within the ACCC.

RECOMMENDATION

Establishing a Franchising Enforcement Unit within the ACCC with sufficient funding to undertake enforcement action for all franchise-related breaches of the *Trade Practices Act* and Franchising Code; and with a specific mandate to pursue test cases to clarify the operation and to identify possible gaps in the application of the *Trade Practices Act* and Franchising Code.

APPENDIX 1

Zumbo Submission to the Productivity Commission's Inquiry into the market for retail tenancy leases in Australia, February 2008

Productivity Commission

INQUIRY INTO THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

Submission
by

Associate Professor
Frank Zumbo

School of Business Law and Taxation
Australian School of Business
University of New South Wales

February 2008

This submission is concerned entirely with exploring key mechanisms for promoting an efficient market for retail leases in Australia. The market for retail leases plays a key role in the Australian economy. Since much of the retailing in Australia still occurs through rented space, the rent paid by a retailer is a key cost of doing business. If the market for retail leases is not working efficiently, then that has an impact on a retailer's cost of doing business. An inefficient market for retail leases distorts competition in the retail sector and distorts the pricing of retail space. An inefficient market for retail leases adds inflationary pressure on consumer prices and in turn the economy.

Unfortunately, the draft report fails to get to the heart of the inefficiencies present in the market for retail leases in Australia. With all due respect, many parts of the report are superficial in their analysis of key inefficiencies in the market for retail leases. In the absence of rigorous economic analysis of key market failures and inefficiencies within the market for retail leases a considerable shadow is cast over the draft report.

The promotion of competition for the benefit of consumers should be the guiding principle for all economic regulators. Regrettably, several key problems in the market for retail leases where not assessed by reference to how consumers would benefit from reforms to ensure the most efficient and competitive market for retail leases in Australia.

What are the key problems leading to an inefficient market for retail leases?

These can be conveniently summarized as follows:

- A lack of transparency in relation to rents;
- A lack of contestability in relation to shopping centres;
- Ineffective laws to deal with anti-competitive price discrimination by landlords; and
- Ineffective laws to stop abuses of unethical conduct by landlords;

A lack of transparency in relation to rents

In any market the lack of transparency in the price of goods or services represents a significant market failure. In this case market failure arises because prices are not determined by an open and transparent process. Markets fail where prices are determined by secret deals, information asymmetries or abuses of market power that inflate or distort prices.

Markets operate most efficiently where all participants are fully informed. Conversely, markets are the least efficient where secrecy surrounds pricing within that market or the market is characterized by information asymmetries.

Given that the efficient operation of the price mechanism is essential for the efficient operation of markets, any tampering, secrecy or lack of transparency surrounding pricing within that market should ring very loud alarm bells. Such alarm bells should be ringing very loudly within the market for retail leases in Australia.

The mandatory registration of leases offers the most efficient mechanism for promoting transparency in relation to rents. Mandatory registration of leases in today's information technology environment should be very easy and quite cheap. We can search the internet for the price of almost anything, but we can't do that for retail space. Where does a small retailer get that information? They can approach commercial providers, but those databases are typically limited by the inconsistent levels of registration across Australia. Why can't a person be allowed to access lease data directly from Government databases?

Shopping centre owners have considerable information at their disposal and may even share that information amongst themselves. The small retailer may only have access to a faction of the information possessed by the shopping centre owner. How can the small retailer negotiate efficiently in that environment, especially at lease renewal?

A number of proposals are presented in this Submission that would promote transparency of rents and enable small retailers to make informed decisions regarding the level of rent they are being asked to pay and, in particular, to see how that compares to::
(i) rents paid by anchor tenants and large retailers in the shopping centre; and
(ii) rents paid by the same type of small retailers in other shopping centres operated by the same shopping centre owner or manager. This information would be required to be included in a disclosure document provided to a tenant. Under the proposals, the anchor tenant or large retailer and the same type of small retailers in other centres would not be named thereby overcoming any confidentiality issues.

In this way, small retailers would be able to make an informed assessment up front of rents they are being asked to pay as compared to the levels of rent paid by comparable tenants in other shopping centres, as well as the levels of rent paid by the anchor tenants in the shopping centre. Both of these pieces of information would be extremely relevant to the potential viability or otherwise of the small retailer's business. For example, if the small retailer was paying a rent higher that a comparable tenant in another shopping centre, the small retailer would seriously need to consider whether the higher rent in this shopping centre is justifiable and whether the small retailer's business will be viable given the higher rent.

Transparency of comparable rents by comparable tenants in other shopping centres

Transparency regarding the rent paid by comparable tenants in other shopping centres operated by the same shopping centre owner or manager could be achieved efficiently, while totally avoiding confidentiality issues. Such disclosure should specify the rent paid by the comparable tenant as well as listing the type and amount of any lease incentives given directly or indirectly to that comparable tenant. The following table is an example of the way the information could be presented in disclosure documents provided to tenants in a shopping centre:

Anonymous Shopping Centre No.1 Specify: - State/Territory and - If City/Regional	Specify Rent paid by a comparable tenant per sq metre	List type and amount of any lease incentives given directly or indirectly to that comparable tenant
Anonymous comparable tenant A		
Anonymous comparable tenant B		
Anonymous comparable tenant C		

Anonymous Shopping Centre No.2 Specify: - State/Territory and - If City/Regional	Specify Rent paid by a comparable tenant per sq metre	List type and amount of any lease incentives given directly or indirectly to that comparable tenant
Anonymous comparable tenant A		
Anonymous comparable tenant B		

A table modeled on the above would be prepared for each shopping centre operated by the same shopping centre owner or manager and would be required to be included in a Disclosure document to each tenant thereby

allowing the tenant access to information on comparable rents and lease incentives paid by comparable tenants in other shopping centres operated by the same shopping centre owner or manager.

Transparency of rents paid by anchor and large tenants in the particular shopping centre

Similarly, the small retailer should be aware of the rent paid by anchor/large tenants in their shopping centre as the small retailer may be competing with the anchor/large tenants for some or all of its business. Small retailers need to be fully aware of the nature and extent of any competitive disadvantage that they may be under in comparison to the anchor/large tenants as a result of the lower rents paid or incentives received by the anchor/large tenants. While small retailers may be aware that anchor/large tenants pay a lower rent, small retailers need to know the full magnitude of the differences in rent between anchor/large tenants and small retailers. Consequently, it is critical from a transparency point of view that there be full disclosure of rents paid by anchor/ large tenants and the types and amounts of any lease or other incentive payments given directly or indirectly to anchor/large tenants.

Such disclosure can be made anonymously thereby totally avoiding any confidentiality issues. It is the disclosure of the level of rent and other incentives received by the anchor and large tenants that is relevant to an efficient markets and not the identity of the particular anchor or large tenant. The following is an example of the way the information could be presented in disclosure documents provided to tenants in a shopping centre:

Name of Shopping Centre:

	List Rent paid by anchor/large tenant per sq metre	List type and amount of any lease incentives given directly or indirectly to that anchor/large tenant
Anonymous Anchor/large tenant A		
Anonymous Anchor/large tenant B		
Anonymous Anchor/large tenant C		
Anonymous Anchor/large tenant D		
Anonymous Anchor/large tenant E		

Transparency relating to disputes and litigation

Transparency relating to disputes between existing and past tenants with the shopping centre owner or manager would provide potential tenants would considerable information about the operation of the shopping centre and, in particular, about the owner's or manager's management style and performance. Such disclosure would enable potential tenants to review the number and nature of disputes and litigation involving the shopping centre owner and manager. This would enable potential tenants to assess if the shopping centre has underlying problems or whether the owner's or manager's performance is lacking in some way.

Indeed, a high level of disputes may indicate that the shopping centre is not a harmonious place in which to operate or that there are issues about the treatment of tenants within the shopping centre. High levels of disputes may also indicate that the shopping centre is performing below expectations and this is leading to high levels of debt recovery actions by the shopping centre or to large number of claims against the shopping centre for misleading or deceptive conduct. Disclosure relating to litigation involving the shopping centre owner or manager needs to cover all litigation relating to the operation or management of all shopping centres in which the owner or manager is involved across Australia.

A precedent for disclosure of information relating to litigation is provided by Item 4.1 of the Disclosure Document required under the Mandatory Franchising Code of Conduct:

4 Litigation

4.1 Details of:

(a) current proceedings by a public agency, criminal or civil proceedings or arbitration, relevant to the franchise, against the franchisor in Australia alleging:

(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

(vi) an offence of dishonesty; and

Transparency relating to leases not renewed or surrendered

Transparency relating to the number of leases not renewed or surrendered and the reasons for these events where known to the shopping centre owner or manager is essential if a potential tenant is to determine whether the shopping centre owner or manager is engaging in any "churning" within the shopping centre. Churning occurs where shops throughout a shopping centre go through a cycle of tenants failing or not being renewed with the space then

falling empty and being offered to new tenants who may then subsequently also fail thereby repeating the cycle. Churning may put a potential tenant on notice that the rents paid by small retailers are unsustainably high thereby contributing or causing the failure of such small retailers. Churning may also put a potential tenant on notice that the shopping centre is underperforming thereby contributing or causing the failure of small retailers within the shopping centre.

Potential tenants also need to be aware of the reasons why leases have not been renewed. Where the number of leases not renewed is high, a potential tenant is put on notice that their lease is unlikely to be renewed at its expiry, particularly if the shopping centre owner or manager does not adequately explain the reasons why there is such a high rate of non-renewal of leases. This will emphasize the importance of negotiating a lease of sufficient duration to be able to obtain a return on their investment.

A precedent regarding such events as the non-renewal or cessation of operations is provided by Item 6.4 of the Disclosure Document required under the Mandatory Franchising Code of Conduct:

> 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 the franchisor;
>
> (d) the franchise agreement was terminated by the franchisee;
>
> (e) the franchise agreement was not renewed when it expired;
>
> (f) the franchised business was bought back by the franchisor;
>
> (g) the franchise agreement was terminated and the franchised business was acquired by the franchisor.
>
> *Note* An event may be counted more than once if more than 1 paragraph applies to it.

Transparency relating to increases in rents imposed on lease renewal

Potential tenants should also be told upfront about the level of rent increases that the shopping centre owner or manager has imposed on tenants renewing leases in the shopping centre. A table should be provided to potential tenants of the rent increases imposed on tenants who have renewed their leases in the particular shopping centre in the previous three to five years. Similarly, a potential tenant should also be provided with information regarding any conditions that were imposed by the shopping centre owner that required the expenditure of money by the renewing tenant as a condition of the lease renewal.

The level of rent increases and any conditions requiring the expenditure of money as a condition of the lease renewal are critical pieces of information as

they would give the potential tenant an idea of the possible rent increases it would face if the tenant subsequently sought and obtained a renewal of the lease. While of course the level of rent increases and conditions imposed in previous years are only indicative, they do provide the potential tenant with a very clear picture of what *may* happen at renewal time. The potential tenant needs to have the complete picture of the risks and rewards involved with leasing space in a shopping centre. Transparency in relation to possible rent increases and imposition of conditions requiring the expenditure of money is critical to giving potential tenants this complete picture.

Such transparency would avoid any confidentiality issues by simply not identifying the particular tenant that was renewed. The table would merely specify the rent increases and imposition of conditions as they relate to each anonymous tenant renewed in the particular year. The following table is an example of the way the information could be presented in disclosure documents provided to tenants in a shopping centre:

Name of Shopping Centre:

	In relation to each lease renewed in 2005 specify (i) the level of rent increase or decrease; and (ii) any conditions requiring the expenditure of money as a condition of the lease renewal	In relation to each lease renewed in 2006 specify (i) the level of rent increase or decrease; and (ii) any conditions requiring the expenditure of money as a condition of the lease renewal	In relation to each lease renewed in 2007 specify (i) the level of rent increase or decrease; and (ii) any conditions requiring the expenditure of money as a condition of the lease renewal
Anonymous renewing tenant A			
Anonymous renewing tenant B			
Anonymous renewing tenant C			
Anonymous renewing tenant D			
Anonymous renewing tenant E			

Anti-competitive Price Discrimination

While anti-competitive price discrimination is a form of anti-competitive conduct intended to be covered by s 46 of the *Trade Practices Act*, it remains a problem area given the current ineffectiveness of s 46. Indeed, the repeal of s 49 of the *Trade Practices Act* in 1995 was premised on s 46 being adequate to deal with anti-competitive price discrimination. Unfortunately, s 46 has failed to live up to expectations in this regard.

While it is clear that price discrimination occurs in the market for retail leases within shopping centres, there is no rigorous economic analysis in the draft report of the impact of that price discrimination on the level of competition between large and small business retailers in that shopping centre. For example, if the rent paid by large retailers is a fraction of the rent paid by a small retailer, then that small retailer is unable to provide any competitive constraint on the large retailer for the benefit of consumers.

Sure, large retailers may compete with one another, but with small retailers at a substantial competitive disadvantage because of the much higher rents they pay, large retailers need not compete as aggressively on price as they would have if small retailers were able to provide a competitive constraint on the large retailers. With shareholder pressure on all large retailers to show record profits and to grow profit margins, lower rents may be pocketed by the large retailers rather than being passed them onto consumers. Clearly, there is a very real danger that price discrimination in the market for retail leases in shopping centres is deterring or preventing competitive conduct within that market in a way that is substantially detrimental to consumers. In short, price discrimination can be anti-competitive in that a small retailer is simply unable to compete effectively and consumers are denied the benefits of vigorous competition between large and small retailers. Needless to say, if small retailers are unable to be competitive because of the much higher rents they pay in comparison to large retailers, there is a further and very real danger that they will go out of business.

Given the dangers to competition posed by price discrimination, rigorous analysis is needed regarding the level and impact of price discrimination in the market for retail leases in shopping centres. There needs to be an understanding of how the lower rents paid by large retailers are cross-subsidized by the higher rents paid by small retailers.

Obviously, the lower the rents paid by large retailers in a shopping centre, the higher the rents that the shopping centre needs to charge small retailers in order for the shopping centre to be viable. Clearly, there is a level of rent across the centre that needs to be received by the shopping centre in order for it to be viable and, therefore, the lower the rents paid by large retailers, the higher the rents that need to be paid by small retailers to make up the shortfall from the large retailers. In view of the inevitable cross-subsidy being paid by small retailers to fund the lower rents paid by large retailers, it is essential that we understand the impact of the price discrimination on the level of competition in shopping centres. This requires an assessment of whether

large retailers and/or shopping centres are exerting market power in a way that distorts rents in shopping centres in an anti-competitive manner.

Where anti-competitive price discrimination is found, it should be dealt with under the *Trade Practices Act*. Given the continued ineffectiveness of s 46 it may be appropriate to amend the *Trade Practices Act* to deal specifically with anti-competitive price discrimination. A number of international precedents are available including the United States *Robinson-Patman Act of 1936* and s 50(1)(a) of the Canadian *Competition Act*:

> **50.** (1) Every one engaged in a business who
>
> (*a*) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to the purchaser, is available to the competitors in respect of a sale of articles of like quality and quantity, …
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

As well as s 18 of the United Kingdom *Competition Act 1998*:

> **18.** - (1) Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in-
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> …
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; …

A lack of contestability in relation to shopping centres

Efficient markets require low barriers to entry and contestability within those markets. In relation to shopping centres, there are high barriers to entry from zoning laws which prevent or deter new entrants to that market and, in turn, allow shopping centres to extract monopoly rents. There needs to be rigorous economic analysis of the use of zoning laws to deter competition in relation to shopping centres.

In particular, a rigorous economic analysis needs to be undertaken of the number and nature of objections lodged by shopping centre owners to proposed developments. This analysis should also extend to the number and nature of objections lodged by major retailers to proposed developments. Such a rigorous economic analysis would provide a complete picture of whether shopping centres and major retailers are using zoning laws in an anti-competitive manner to raise barriers to entry and stifle competition to the substantial detriment of consumers. An anti-competitive use of zoning laws prevents the market for shopping centres being contestable thereby allowing shopping centre owners to exploit their monopoly power to the substantial detriment of consumers.

Indeed, using zoning laws to raise barriers to entry and prevent entry in the market for shopping centres allows shopping owners to extract higher rents than they would have been able if the market for shopping centres was contestable and efficient. An inefficient market for shopping centres means that the higher rents extracted because of a shopping centre's monopoly position are passed onto consumers and, more dangerously for the economy, such monopoly rents push up inflation.

Stronger laws to stop unethical conduct by landlords

With s 51AC of the *Trade Practices Act* approaching its tenth anniversary it is opportune to reflect on that law's inability to provide a clear standard of ethical conduct. While s 51AC held great promise of becoming the benchmark for appropriate standards of ethical conduct, the Courts have stood in the way of this happening. Indeed, the onerous interpretation given by the Courts to s 51AC means that s 51AC has largely fallen into disuse. It is simply too difficult and expensive to bring s 51AC cases.

Section 51AC: What are its problem areas?

From the outset, it is clear that s 51AC suffers from the following limitations:

- There is no statutory definition of "unconscionable conduct;"
- The list of factors provided in s 51AC do not define what is "unconscionable" for the purposes of s 51AC; and
- There is a monetary cap of $10 million on the cases that can be brought under s 51AC.

While the previous Government made a number of amendments to s 51AC in its dying days,[25] it is clear that the amendments are cosmetic and fail to address underlying concerns with the operation of s 51AC. For example, the previous Government added a "new" factor to the non-exhaustive list of factors that the court may have regard to in determining whether there is breach of s 51AC of the *Trade Practices Act 1974*. That factor would "allow" the Court to consider:

> "(ja) whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer for the supply of the goods or services;"

The inclusion of a "new" factor dealing with a contractual right to vary unilaterally a term or condition of a contract adds nothing meaningful to s 51AC as the court is already able to consider any matter that it considers relevant to determining whether conduct is unconscionable under s 51AC.

It would be misleading to suggest that the insertion of a "new" factor to the non exhaustive list in s 51AC is necessary to allow the Courts to have regard to that factor in future cases. Similarly, it would be misleading to suggest that in the absence of such a "new" factor the Courts could not have regard to the factor.

It is important to note that the listing of factors in s 51AC does not elevate those factors to a definition of unconscionable conduct. Indeed, it would also be misleading to suggest that the factors included in s 51AC provide a definition of what is "unconscionable" under s 51AC. The question of whether

[25] See *Trade Practices Legislation Amendment Act (No. 1) 2007*.

or not conduct is unconscionable under s 51AC is considered by reference to the individual circumstances of the case having regard to all matters considered relevant by the Court irrespective of whether or not those matters are listed in s 51AC. So under s 51AC the listed factors may be considered by a Court, but so can factors not listed also be taken into account if the Court considers them to be relevant.

In short, the addition of a factor in s 51AC does not better define the term "unconscionable conduct" but merely makes a cosmetic change to the list. Importantly, adding or subtracting factors to s 51AC as currently drafted would not impact on what the Courts consider to be "unconscionable" as the Courts have defined the term independently of the factors in s 51AC.

Promoting ethical business conduct: A way forward

The following represent a variety of statutory alternatives to promoting ethical business conduct:

- Inserting a statutory definition of the term "unconscionable;"

- Inserting a statutory list of examples of the types of conduct that would ordinarily be considered to be "unconscionable;"

- Enacting a new legislative framework within the Trade Practices Act to deal with unfair contract terms in business to business contracts involving small retail tenants; and

- Enacting a statutory duty of good faith;

Inserting a statutory definition of the term "unconscionable"

The insertion of a definition of "unconscionable" in s 51AC would be an obvious way to provide clear statutory guidance as to what is meant by the term as it is used in s 51AC.[26] Importantly, the insertion of a statutory definition in s 51AC would send a clear parliamentary signal to the Courts that the concept is not only broader than the present judicial interpretation of the concept, but that s 51AC is intended to promote ethical business conduct. Such a definition would set out a non-exhaustive benchmark for assessing conduct to determine whether or not it goes beyond what is reasonably necessary to protect the legitimate interests of the parties involved. This would not in any way interfere with the driving of a "hard" bargain, but rather would provide clear statutory guidance as to what is considered to be unethical. Currently, in the absence of a statutory definition in 51AC of the term "unconscionable" the Courts are being left to define the term and, in doing so,

[26] See Zumbo F., "Commercial Unconscionability and Retail Tenancies: A State and Territory perspective," (2006) *Trade Practices Law Journal*, Vol. 14, p 165 at p. 171 – 172.

are taking such an onerous view of what constitutes “unconscionable” that s 51AC is falling into disuse.

Inserting a statutory list of examples of the types of conduct that would ordinarily be considered to be “unconscionable”

An alternative to inserting a statutory definition of “unconscionable” would be to recast the exiting list of factors under s 51AC to represent *examples* of conduct that would ordinarily be considered to be “unconscionable.” Currently, the factors can be considered or dismissed at the Court’s discretion and as mere factors certainly cannot be seen to define what is unconscionable. Recasting the factors into examples of unconscionable conduct would provide considerable and practical statutory guidance as to what is meant by the term “unconscionable.” The following draft provision sets out how a statutory list of examples could be drafted:

> “Without in any way limiting the conduct that the Court may find to have contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the ***business consumer***), the following will, in the absence of evidence to contrary, be regarded as unconscionable for the purposes of subsection (1) and (2):
>
> - the supplier used its superior bargaining position in a manner that was materially detrimental to the business consumer; or
> - the supplier required the business consumer to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; or
> - the suppler was aware and took advantage of the business consumer’s lack of understanding of any documents relating to the supply or possible supply of the goods or services; or
> - the supplier exerted undue influence or pressure on, or engaged in unfair tactics against, the business consumer or a person acting on behalf of the business consumer; or
> - the supplier's conduct towards the business consumer was significantly inconsistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; or
> - the supplier failed to comply with any relevant requirements or standards of conduct set out in any applicable industry code; or
> - the supplier unreasonably failed to disclose to the business consumer:
>   - any intended conduct of the supplier that might affect the interests of the business consumer; or
>   - any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); or

- the supplier was unwilling to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; or
- the supplier exercised a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer for the supply of the goods or services in a manner that was materially detrimental to the business consumer; or
- the supplier acted in bad faith towards the business consumer."

Enacting a new legislative framework to deal with unfair contract terms in business to business contracts involving small businesses

Providing for greater judicial scrutiny of unfair contract terms would go a long way to promoting ethical business conduct. Such scrutiny of unfair contract terms is currently lacking and unfortunately can act as a green light to unethical landlords that are intent on including contract terms that go beyond what is reasonably necessary to protecting the landlord's legitimate business interests. In such circumstances, a new legislative framework is needed to deal with unfair contract terms. Such a framework would help promote greater judicial scrutiny of unfair contract terms and could be based on the United Kingdom[27] and Victorian[28] legislation for dealing with unfair terms in consumer contracts.[29]

Such a framework should have the following features;

- A clear definition of an unfair contract term;
- include a comprehensive listing of potentially unfair contract terms which provides clear statutory guidance to consumers, businesses and the Courts regarding the types of terms considered to be unfair;
- contain an ability to prescribe particular terms or classes of terms as "unfair" so that widespread consumer detriment can be prevented in advance and without the need to separately pursue each individual use of the unfair term or terms;
- impose a penalty for using a prescribed unfair term as a necessary deterrent against the use of terms recognized as being unfair;
- have a well resourced Government enforcement agency to respond to allegedly unfair contracts terms in a timely and pro-active manner to minimize the actual or potential detriment arising from the term;

---

[27] The UK legislation was implemented first and is now found in the *Unfair Terms in Consumer Contracts Regulations 1999*. These Regulations came into force on 1st October 1999.

[28] The Victorian legislation is found in Part 2B of the *Fair Trading Act 1999* and came into force on 9 October 2003.

[29] For a discussion of the operation of the United Kingdom and Victorian legislation see Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" *Trade Practices Law Journal*, Vol. 13, pp. 70 - 89; Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: The search for a new regulatory model," *Trade Practices Law Journal*, Vol. 13, pp. 194 - 213; and Zumbo, F., (2007), "Promoting Fairer Consumer Contracts: Lessons from the United Kingdom and Victoria", *Trade Practices Law Journal*, Vol. 15, pp. 84-95.

- provide guidance and education to both businesses and consumers to maximize awareness and understanding of the legislative framework;
- allow for enforceable undertakings to be provided to Government agency to enable matters to be resolved quickly and without recourse to the Courts;
- allow for advisory opinions by Government enforcement agency to enable particular businesses and industries to seek specific guidance in advance of using terms considered at risk of being viewed as unfair;
- allow for advisory opinions by quasi-judicial body to provide businesses or the Government enforcement agency the opportunity to secure a binding opinion as to the whether or not a particular term is unfair; and
- allow for private enforcement of the framework to enable those affected parties to recover any loss or damage arsing from an unfair contract term.

Enacting a statutory duty of good faith

While any statutory definition of "unconscionable" could usefully rely on the concept of good faith as a means of ensuring the Courts take a broader approach to s 51AC than their presently onerous and very legalistic approach to the section, an alternative would be to enact a stand-alone statutory duty of good faith. Either way, the concept of good faith offers considerable potential as a mechanism for promoting ethical business conduct. Indeed, this is readily apparent from the growing judicial attention and support given to an implied duty of good faith in commercial contracts, especially in New South Wales.[30]

A convenient summary of the nature and scope of an implied duty of good faith was recently provided by Gordon J in *Jobern Pty Ltd v BreakFree Resorts (Victoria) Pty Ltd*:[31]

> 146 Specific conduct has also been identified by various courts as constituting '*bad faith*' or a lack of '*good faith*' including:
> (1) acting arbitrarily, capriciously, unreasonably or recklessly: e.g. see Viscount Radcliffe in *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415 at 1422-23 cited by Gyles J in *Goldspar* at [173]; and *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65];
> (2) acting in a manner that is oppressive or unfair in its result by, for example, seeking to prevent the performance of the contract or to withhold its benefits: *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65]-[66];

[30] See for example *Renard Constructions (ME) Pty Limited v Minister for Public Works* (1992) 26 NSWLR 234; *Alcatel Australia Limited v Scarcella* [1998] NSWSC 483 (16 July 1998*); Burger King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187: *Overlook v Foxtel* [2002] NSWSC 17 (31 January 2002); and *Vodafone Pacific Ltd & Ors v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004).
[31] [2007] FCA 1066 (23 July 2007).

> (3) failing to have reasonable regards to the other party's interests: *Overlook Management BV v Foxtel Management Pty Ltd* (2002) ACR 90–143 at [67] …
> (4) failing to act 'reasonably' in general. …

Clearly, the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.

Conclusion

In summary this submission has canvassed a variety of initiatives and proposals that would promote a competitive and ethical market for retail leases for the benefit of Australian consumers. A competitive and ethical market for retail leases is essential if Australia is to keep inflation as low as possible. With the market failures and inefficiencies found in the market for retail leases in Australia, it is essential that Australia has a world's best *Trade Practices Act* to deliver real benefits to Australian consumers. Sadly, Australia's *Trade Practices Act* is severely lacking in key areas such as the prevention of abuses of power by landlords, and the prevention of unethical conduct by landlords towards small tenants.

In calling for the strengthening of the *Trade Practices Act* one must immediately dispel a number of ill-founded concerns expressed by the opponents of such strengthening. Firstly, the changes proposed in this Submission are not about protecting small retailers from competition. The essence of our economic system is competition. It is competition that is to be protected. This requires that the market for retail leases be efficient.

Secondly, the opponents of a strengthening of the *Trade Practices Act* will say that changes will bring uncertainty. Well, they would say that given that they know that key provisions of the *Trade Practices Act* are currently not working and giving them the green light to potentially behave anti-competitively or unethically. Today the opponents of changes have certainty that they can behave anti-competitively or unethically. But changes to the *Trade Practices Act* would remove the certainty they currently have to behave anti-competitively or unethically.

So, yes, we have certainty at the moment, but that certainty relates to fact that key provisions of the *Trade Practices Act* are not working to promote competition and ethical conduct in the market for retail leases in Australia. That certainty regarding the current failure of the *Trade Practices Act* to stop anti-competitive or unethical conduct tells us that we need change and we need it urgently. Of course, such changes need to be carefully drafted. Carefully drafted changes to the *Trade Practices Act* will ensure that everyone is certain about how those new laws are intended to operate in stopping anti-competitive or unethical conduct.

Finally, it is not only effective laws that are needed against anti-competitive and unethical conduct, but there is a pressing need for additional mechanisms to promote the timely and cost effective resolution of disputes. Consideration should be given to the establishment of a retail tenancy advocate or ombudsman, who would be available to identify and deal with emerging trends or problem areas long before they threatened the efficient operation of the market for retail leases in Australia.

APPENDIX 2

Zumbo F., (2001), "Australia's Mandatory Franchising Code of Conduct: Successes, Challenges and Lessons," *Trade Practices Law Journal*, Vol. 9, pp. 213-235.

APPENDIX 3

Zumbo F., (2006), "Commercial Unconscionability and Retail Tenancies: A State Territory Perspective," *Trade Practices Law Journal*, Vol. 14, pp. 165-174.

APPENDIX 4

Zumbo, F., (2006), "Promoting Fairer Franchise Agreements: A Way Forward?" *Competition and Consumer Law Journal*, Vol. 14, pp. 127-145.

APPENDIX 5

Zumbo, F., (2007), "Australian Franchising Disputes: An Examination of Causes and Remedies since 1998," Presented at the 21th Annual International Society of Franchising Conference, Las Vegas, USA, 23-25 February 2007, pp 1-29.

APPENDIX 6

Zumbo, F., (2007), "Are Australia's Consumer Laws Fit for Purpose?"
Trade Practices Law Journal, Vol. 15, pp. 227-237.

Australia's Mandatory Franchising Code of Conduct: Successes, Challenges and Lessons

Frank Zumbo

Senior Lecturer
School of Business Law and Taxation
University of New South Wales

As countries around the world introduce or consider introducing franchising specific legislation, it is timely to review Australia's use of a mandatory code of conduct as a regulatory framework for franchise arrangements. In doing so, the article will consider the level of industry consultation undertaken before and after the Code's introduction, the impact of such consultation, and the Code's flexibility in responding to the changing needs of the Australian franchising sector. Remaining challenges in relation to the Code are identified and discussed with particular reference to industry reaction since the Code's introduction.

With the mandatory Franchising Code of Conduct (the Code) now firmly in place as the cornerstone of Australian franchising regulation, it is timely to reflect upon the successes, challenges and lessons arising from the Code's implementation. In doing so, the experiences associated with the Code's development and operation can be critically evaluated and valuable insights gained as to how the Code can be used to deal not only with existing issues within the franchising sector, but also with issues that may emerge over time. Indeed, the Code's flexibility in meeting the changing requirements of the Australian franchising sector will undoubtedly be a key factor in its success as a regulatory framework.

Not surprisingly, this flexibility will be linked to such factors as the ongoing review of the Code, the level of consultation that takes place with the sector, and the willingness of the federal Minister for Small Business to fine-tune the Code where required. By undertaking regular reviews of the Code and promoting the widest possible consultation with franchising participants, the Code can continue to meet the needs of the sector, or simply be withdrawn. Thus, unlike franchising specific legislation that can only be changed or repealed through the formal law-making process, the Code, given that it is part of a regulation under the *Trade Practices Act* 1974 (Cth) (the Act),[1] can be altered or withdrawn through a subsequent regulation made under the Act. Clearly, a Code that is part of a regulation can be fine-tuned on a more timely basis than franchising specific legislation and, accordingly, is more likely to be responsive to the changing needs of the Australian franchising sector.

Such responsiveness, however, is not achieved at the expense of an appropriate level of parliamentary scrutiny of a Code having the force of law under the Act. Indeed, while the federal Parliament has, pursuant to Pt IVB of the Act, effectively delegated the responsibility for drafting the actual Code to the relevant federal Minister, any regulation containing the Code or changes to it is required to be tabled in Parliament and can potentially be disallowed. By requiring the tabling of the regulations under the Act, Parliament is able to have the final say on the content of the Code or changes to it, while allowing the Code to be shaped though direct consultation with franchising participants. In such circumstances, the benefits of a wide-ranging consultative process can be combined with the benefits associated with

[1] See in particular ss 51AD and 51AE of the Act.

parliamentary oversight of a legally enforceable Code under the Act.

Overall, therefore, it is appropriate to assess the Code's development and operation by reference to such matters as the level of consultation throughout the Code's development and subsequent implementation, the Minister's readiness to fine-tune the Code in response to industry feedback, and industry reaction to the Code.

The value of consultation

From the outset, it is readily apparent that consultation with franchising participants is extremely valuable in ensuring that the Code is not only responsive to the needs of the franchising sector, but that such needs are met in the most cost-effective manner possible. Clearly, consultation allows sector-wide conduct issues to be identified and dealt with in an appropriate and timely manner. In doing so, any existing or emerging issues within the franchising sector can be identified, objectively assessed and, where necessary, be dealt with as part of the Code. Such consultation ensures that any competing interests between franchising participants are weighed, and, more importantly, allows any concerns and perceived limitations of the Code itself to be aired and thoroughly debated.

Appropriately, consultation enables all franchising participants to become involved in the process and to contribute to the Code's evolution. While at times such consultation will produce wide-ranging debate about the Code and its perceived operation, such debate is particularly useful in making franchising participants stakeholders in the Code. Needless to say, such involvement will be critical to the level of general industry support enjoyed by the Code.

Industry consultation: the experience so far

Sector-wide consultation has been a key feature in the development and subsequent review of the Code. Indeed, such consultation has been ongoing, having commenced immediately after the Federal Minister announced the government's decision to proceed with a mandatory code for the sector. During this time the federal Office of Small Business (the OSB) has received numerous submissions regarding the two public exposure drafts of the Code, an exposure draft of proposals regarding the issue of disclosure within master franchising arrangements, and, more recently, a discussion paper on the Code's 1999/2000 review. Such submissions, together with the creation of the Franchising Policy Council (the FPC) as a non-statutory body to advise the Minister on the Code and related franchising matters, provide clear evidence of the considerable opportunity for industry input.

Indeed, the FPC has, since its appointment in March 1998, formed a valuable part of the consultative process. With its membership being made up of an independent chair, franchisors, franchisees and industry advisers, the FPC has been well placed to review submissions from franchising participants and to make appropriate suggestions to the Minister as to the structure and terms of the Code. In doing so, the FPC has made a significant contribution to the Code's development and its 1999/2000 review. Not only has the FPC contributed its expertise and time, but it has also provided a focused vehicle for considering divergent industry viewpoints. Thus, having met on numerous occasions with all stakeholders within the franchising sector, the FPC has provided a valuable forum for putting industry views.

While the FPC has formed an important part of the consultative process, it is readily apparent that the quality and level of consultation from that process has depended very much on the franchising sector's awareness of proposed changes to the Code and/or Code reviews. Such awareness is critical to an industry participant's ability to respond to such changes and/or reviews. Clearly, the greater the awareness of proposed changes and/or reviews by industry participants, the greater the likelihood that those participants will contribute to the Code and its evolution over time to meet the needs of the sector.

Within this context, it is useful to consider not only the extent to which the Code's development and its 1999/2000 review were publicised to the sector, but also the opportunity for industry participants to obtain copies of proposed changes and relevant material.

Industry consultation during the Code's development

The period, covering the time between the federal government's announcement on 30 September 1997 that it intended to mandate a code of conduct under the Act and 1 July 1998 (the commencement date of the regulation prescribing the Code under the Act) was particularly critical in terms of industry

consultation. Not only was the federal government proposing a new regulatory framework for Australian franchising arrangements, but it had also committed itself to the timely implementation of the new framework. Needless to say, the proposed new framework prompted mixed reactions from the Australian franchising sector. Indeed, while some expressed concern as to the perceived need for a mandatory code of conduct and the compliance costs likely to follow its introduction, others welcomed the government's proposals as effectively dealing with the regulatory vacuum left by the failure of the sector's self-regulatory code.

Not surprisingly, the divergent views within the sector produced robust debate as to both the perceived need for a code and the terms of any such code. Such debate centred very much around the two exposure drafts that had been issued in September 1997 and April 1998 respectively. Indeed, the release and timely availability of the exposure drafts on the then federal Department of Workplace Relations and Small Business website[2] prompted a flurry of submissions to the federal Minister, the OSB and, from March 1998 onwards, the FPC.

Importantly, this high level of industry input was linked to such factors as:

- the accessibility of the two exposure drafts – September 1997 and April 1998 – on the internet;
- the work of industry associations in promoting discussion on the exposure drafts;
- numerous advertisements having been placed in daily newspapers; and
- the work of the OSB in promoting awareness of the existence of the exposure drafts.

Such extensive promotional activities ensured that interested parties were well aware of the developments leading up to the implementation of the Code and could respond in a timely fashion. Indeed, the extensive nature of the consultative process during this period ensured that the federal government, the OSB and the FPC all had the opportunity to hear a range of industry views and, accordingly, such views were able to be taken into account in the Code's development.

[2] http://www.dewrsb.gov.au

Industry consultation between commencement of the Code and the 1999/2000 review

This period, covering the time between 1 July 1998 and December 1999 – the scheduled start of the 1999/2000 Code review – gave rise to such important challenges as promoting awareness of the new Code and ensuring that the infrastructure intended to support the Code was in place. From the outset, considerable effort was devoted to publicising the Code and making copies of it available to industry participants. This effort was again greatly assisted by the internet, with the Code being available on the websites maintained by federal Department of Employment, Workplace Relations and Small Business[3] and the Australian Competition and Consumer Commission (the ACCC),[4] the regulatory body having responsibility for the Code's enforcement. In addition, large numbers of printed copies of the Code were distributed by the ACCC and the OSB to industry associations generally, as well as to industry participants attending Australia-wide promotional seminars conducted on the Code by the ACCC and supported by the Franchise Council of Australia and the OSB.[5]

In terms of infrastructure intended to support the Code, this period saw considerable effort being devoted by the ACCC to franchising matters. Apart from the Australia-wide promotional seminars mentioned above, the ACCC set aside space on its website[6] to publicise the Code and to provide access to educational material on the Code's operation. This material has since been updated and currently includes:

- the Franchising Code Compliance Manual;
- the Franchising Code Training Manual;
- The Franchisee's Guide; and
- Answers to frequently asked questions on the Code and the *Trade Practices Act* 1974.

The website also provides general information on, and a link to, the Office of the Mediation Adviser, the federally funded Adviser with responsibility for appointing a mediator under the Code in the event that parties to a franchising dispute are themselves unable to agree upon a suitable

[3] http://www.dewrsb.gov.au/smallBusiness/policy/
[4] http://www.accc.gov.au/smallbus/smallbus.htm
[5] See ACCC Media Release, *Franchising wins under new code arrangements*, MR 131/98, 14 July 1998.
[6] http://www.accc.gov.au/smallbus/smallbus.htm

mediator.[7] The Adviser, as an integral part of the new regulatory framework, was appointed during this period, and has itself developed a website.[8]

Significantly, the period between the Code's commencement and the 1999/2000 review also saw continued industry consultation and the release of a major discussion paper (discussed below) on disclosure issues within master franchise arrangements. Indeed, the discussion paper – *Proposal to limit the effect of multiple disclosure of information under a master franchise*[9] – was largely in response to industry submissions on the potential cost of the Code's disclosure requirements within master franchise arrangements. Clearly, industry consultation and input continued after the implementation of the Code. Such ongoing consultation and input provides further evidence of the scope for industry participants to contribute to the Code's evolution.

Industry consultation during 1999/2000 Code review

This period, covering the period between the scheduled commencement of the review in December 1999 and May 2000, also saw a very high level of industry consultation. Indeed, with the 1999/2000 review being the first major review of Code since its commencement, ample time was set aside for industry consultation and every opportunity was taken to publicise the review.[10] Advertisements were placed in daily newspapers and a dedicated website established to allow timely access to discussion papers and other material relevant to the review.[11]

Given such publicity, the industry participants were well aware of the review and had sufficient time in which to make a submission. Numerous submissions were made, and the FPC met with interested parties on several occasions. Clearly, wide-ranging industry consultation was considered an integral part of the 1999/2000 review.

Ongoing consultation

It is readily apparent that consultation with industry participants has been ongoing since the federal government's announcement in September 1997 that it would proceed with a mandatory code of conduct. Such consultation has involved the OSB, the FPC, the ACCC and the Minister. Importantly, this ongoing consultation has provided franchising participants with ample opportunity to present the range of viewpoints on the current operation and future direction of the Code. Indeed, the strength of the ongoing consultative process is that differing viewpoints can be put and objectively reviewed by the OSB, the FPC, the ACCC and, ultimately, the Minister. With such scope to put industry viewpoints, there is a strong likelihood of the Code continuing to strike a balance between, at times, the competing interests within the franchising sector.

As with any debate, some sectors of the industry may call for an extension of the Code, while others may call for a claw back or withdrawal of its provisions. Faced with such opposing viewpoints, the consultative processes available with respect to the Code will not only ensure that any common ground amongst participants is identified, but that in the absence of common ground, an appropriate balance is sought in the interests of franchising generally. In short, the ongoing attention and rigorous debate surrounding the development and implementation of the Code has allowed (and will continue to allow) the Code to evolve as a generally acceptable regulatory framework.

An evolving Code – 1999 amendments

Given that flexibility in meeting changing circumstances can be seen as an advantage of the Code when compared with franchising-specific legislation, it is useful to note the timeliness with which elements of the Code were fine-tuned within a year of its implementation. Unlike amendments to franchising-specific legislation that would have needed to compete with other legislative proposals for parliamentary time, the Code can be changed in a timely fashion by prescribing an amending regulation.[12] Indeed, the amending regulation was

[7] See cll 29 and 30 of the Code.
[8] http://www.mediationadviser.com.au/
[9] Published for the Franchising Policy Council by the Office of Small Business, August 1999.
[10] The review was announced in August 1999 and took place as scheduled between December 1999 and May 2000.
[11] http://www.dewrsb.gov.au/smallBusiness/policy/franchising/review.htm

[12] See Trade Practices (Industry Codes - Franchising) Amendment Regulations 1999 (No 1).

able to make a number of technical changes to the Code aimed at clarifying its operation. These changes, which came into effect on 1September 1999, resulted in:

- the inclusion of definition of both "motor vehicle" and "motor vehicle dealership";
- the exclusion of co-operatives incorporated under the Corporations Law from the ambit of the Code;
- a number of minor amendments relating to master franchising arrangements; and,
- a new requirement relating to the disclosure of the franchisor's territory selection policy.

Significantly, these amendments preceded the commencement of the Code's 1999/2000 review. Having been formulated following submissions to FPC and the OSB, the amendments reveal not only the ongoing consultation with the franchising sector in relation to the Code, but also the willingness of the Minister to make changes in response to such consultation.

Motor vehicle dealerships

While cl 4(2)(b) of the Code deems a motor vehicle dealership to be a "franchise agreement" for the purposes of the Code, the Code, as originally drafted, did not include a definition of a motor vehicle dealership. This omission has been remedied by inserting a definition of both "motor vehicle" and "motor vehicle dealership":

> "'motor vehicle' means a vehicle that uses, or is designed to use, volatile spirit, gas, oil, electricity or any other power (except human or animal power) as the principal means of propulsion, but does not include a vehicle used, or designed to be used, on a railway or tramway.
>
> *Examples of motor vehicles*
>
> 1 motor car
> 2 motor cycle
> 3 motorcycle
> 4 tractor
> 5 motorised farm machinery
> 6 motorised construction machinery
> 7 aircraft
> 8 motor boat
>
> '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."[13]

Taken together, these definitions seek to clarify how far the concept of a "motor vehicle dealership" extends for the purposes of the Code. Given that motor vehicle dealerships are automatically subject to the terms of the Code, it is appropriate that any uncertainty as to what constitutes a motor vehicle dealership be removed. Importantly, the clarification of certain aspects of the Code was clearly an important motivation behind the amending regulation.

Co-operatives incorporated under the Corporations Law

Not surprising, the question of exemptions under the Code is one that has attracted considerable debate. Indeed, given that not only does the Code have the force of law, but also brings with it compliance costs, it is essential that there be certainty as to the scope of the exemptions under the Code. Within this context, the amending regulation has clarified the scope of the exemption with respect to the relationship between members of a cooperative. While originally the Code only excluded cooperatives registered, incorporated or formed under the state and territory laws listed in cl 4(3)(f) of the Code, the Code has now been amended to exclude cooperatives covered by the nationally operative Corporations Law. Under a new cl 4(3)(f)(ix), a relationship between the members of a cooperative governed by the Corporations Law will not in itself constitute a franchise agreement.

Disclosure of the franchisor's territory selection policy

While as originally drafted, item 11.1 of the franchisor disclosure document under Annexure 1 required only that the franchisor disclose its site selection policy, this item has been modified to impose a new requirement on the franchisor to disclose, where relevant, its territory selection policy. The new item 11.1 states:

> "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;

[13] See cl 3(1) of the Code.

(b) the territory in which the franchised business is to operate."

This new requirement is consistent with the Code's intention of providing franchisees with sufficient information on which to make informed decisions about the franchise. In particular, information regarding territory selection (where that is relevant to the franchise) will assist a franchisee in assessing the viability of the franchise.

Master franchising arrangements

The Code's impact on master franchising relationships has been another area in which there has been considerable debate. While such debate has largely focused on the question of disclosure in master franchising arrangements, there has also been some debate regarding the terminology used in relation to such arrangements. In such circumstances, the 1999 amending regulation made a number of small changes involving master franchise arrangements. For example, as part of those amendments, the cl 3(1) definition of "master franchise" was amended to include reference to both a subfranchisor and master franchisee:

"'master franchise' means a franchise in which the franchisor grants to a subfranchisor or master franchisee the right:

(a) to grant a subfranchise; or

(b) to participate in a subfranchise."

A note was then added below cl 6(1), to remind industry participants that the definition of franchisor also covers subfranchisors/master franchisees in their dealings with franchisees:

"6. Requirement to give disclosure document

(1) A franchisor must give a disclosure document under Annexure 1 to:

(a) a prospective franchisee; or

(b) a franchisee proposing to renew or extend a franchise.

Note Under the definition of 'franchisor', a franchisor includes a master franchisee, or a subfranchisor, in its relationship with a subfranchisee: see [cl] 3(1)."

Such changes were intended to put beyond doubt that the Code's disclosure requirements are intended to not only apply between (i) a franchisor and ultimate franchisees, and (ii) the franchisor and subfranchisor/master franchisee, but also between a subfranchisor/master franchisee and ultimate franchisees. In keeping with this intention, the definition of "franchisor" in cl 3(1) was amended to specifically include master franchisees. The new definition states:

"'franchisor' includes the following:

(a) a person who grants a franchise;

(b) a person who otherwise participates in a franchise as a franchisor;

(c) a subfranchisor in its relationship with a subfranchisee;

(d) a master franchisee in a master franchise system;

(e) a master franchisee in its relationship with a franchisee."

When taken together with the Code's other provisions,[14] the changes in relation to master franchising reaffirm that both the master franchisor and the subfranchisor/master franchisee have disclosure responsibilities towards a franchisee. Significantly, this disclosure issue has been one of the more debated issues since the Code's introduction.

Disclosure and master franchising – the Code's obligations

In keeping with the Code's primary objective of ensuring that franchisees have access to relevant information about the franchise, the Code has, in relation to master franchise arrangements, required the disclosure of information to the franchisee at each level of the arrangement. As noted above, the franchisor has a disclosure obligation to the subfranchisor/master franchisee and, in turn, both the franchisor and subfranchisor/master franchisee have a disclosure obligation to franchisees. These disclosure obligations were originally outlined in cll 6(4) and (5).

"(4) If a franchisor proposes to grant a master franchise, the franchisor must give a disclosure document in accordance with Annexure 1 to the prospective subfranchisor or master franchisee.

Note Subclause (4) does not apply to a franchise agreement to which para 5 (3) (a) applies.

(5) If a subfranchisor or master franchisee proposes to grant a subfranchise to a franchisee:

(a) the franchisor and subfranchisor, or the master franchisee:

[14] See the original cll 6(4) and 6(5) of the Code.

(i) must individually give a disclosure document to the franchisee or prospective franchisee; or

(ii) must give to the franchisee or prospective franchisee a joint disclosure document that addresses the respective obligations of the franchisor and the subfranchisor; and

(b) the subfranchisor, or the master franchisee, must comply with the requirements imposed on a franchisor by this Part."

While imposing disclosure obligations within master franchise arrangements, these subclauses would only operate where the arrangement was covered by the Code. With this in mind, it needs to be remembered that an exemption is made in the Code to cover circumstances where a non-resident grants a one-off master franchise in Australia. This exemption is found under cl 5(3):

"(3) However, this code does not apply to a franchise agreement:

(a) if the franchisor:

(i) is resident, domiciled or incorporated outside Australia; and

(ii) grants only 1 franchise or master franchise to be operated in Australia;"

Where the Code is applicable to the master franchise arrangement, a franchisor and a subfranchisor/master franchisee will have the option of providing either their own disclosure documents or a joint disclosure document.[15] In practice, however, there is a reluctance to produce a joint disclosure document in view of the potential for joint liability in the event of an error or omission in the document.

Disclosure and master franchising – the August 1999 proposal

Following industry representations, a discussion paper entitled *Proposal to limit the effect of multiple disclosure of information under a master franchise*[16] was released. It contained an exposure draft of a suggested legislative response intended to limit the effect of multiple disclosure of information within master franchise arrangements. In particular, the discussion paper proposed an amendment to the Code allowing a franchisor within a master franchise arrangement to disclose information to a franchisee only to the extent that it was materially relevant to their specific relationship. This amendment was to be incorporated in a proposed new cl 6(6):

"If a franchisor in a master franchise gives a disclosure document under paragraph (5)(a), the franchisor is not required to include information that is not materially relevant to the relationship between:

(a) the master franchisee, or the master franchise; and

(b) a franchisee or prospective franchisee.

Note 1: It is important for franchisors to understand their responsibilities for the adequacy and relevance of the information included in the disclosure document about the different levels of the franchise business.

Note 2: Detailed information about the disclosure document is set out in Annexure 1."

Clearly, the proposal would place the onus on the franchisor when deciding the level of disclosure that it would provide to franchisees within a master franchise arrangement. In doing so, the proposal raised such issues as to whether or not the Code's existing disclosure obligations provide sufficient flexibility in meeting the needs of master franchise arrangements, and whether or not it is appropriate to impose disclosure requirements on both the franchisor and subfranchisor/master franchisee. Needless to say, these issues of flexibility and appropriateness are inter-related.

On the flexibility issue, it is appropriate to note that the Code as currently drafted does allow franchisors the flexibility to refrain from answering questions considered to be irrelevant to the system. Accordingly, if an item is not relevant to a particular master franchise system, the franchisor is able to answer that the question is not applicable. Since the franchisor is only required to answer relevant items, the present disclosure requirements are concerned with ensuring that franchisees get access to relevant information. Such flexibility in dealing with questions considered to be irrelevant to the system is complemented with the ability under the Code to give a franchisee a joint disclosure document that addresses the respective obligations of the franchisor and the subfranchisor/master franchisee.

Given that all franchisors are currently required to provide a disclosure document, it is readily apparent that the Code in its present form is

[15] See the new cl 6B(2) of the Code.

[16] Published for the Franchising Policy Council by the Office of Small Business, August 1999.

intended to apply consistently across the sector. In doing so, there is certainty as to the application of the Code's disclosure requirements. More importantly, this creates a level playing field in that franchisors themselves are being treated consistently. Indeed, if particular classes of franchisors were treated differently in terms of disclosure obligations, there would be the risk that franchisors may structure their affairs so as to take advantage of any perceived differences in the disclosure obligations imposed on different classes of franchisors. In these circumstances, the structure of a franchise arrangement could be driven by regulatory considerations rather than what is best for the particular system. In short, the Code's disclosure obligations are presently imposed across the board and irrespective of the type of structure used to operate the franchise system. Such uniformity of treatment prevents anomalies from arising and ensures consistency in disclosure documents.

This consistency in disclosure documents is undoubtedly a cornerstone of the Code. By requiring all franchisors to adhere to the same format in producing a disclosure document, franchisees get the benefit of consistent disclosure. Importantly, this consistency is advantageous to the extent that it allows franchisees to make comparisons between franchise systems that, in turn, enable them to make an informed choice as to the system that best suits their needs.

In summary, the benefits of the present disclosure obligations within master franchise arrangements include:

- Consistency of disclosure throughout the sector;
- A level playing field between franchisors;
- certainty as to the application of the Code's disclosure requirements – the same standards applying to all franchisors;
- Disclosure documents which enable franchisees to make comparisons across systems; and
- Provision of relevant information allowing franchisees to make informed decisions;

Such benefits need to be weighed against the costs of the existing disclosure obligations. Not surprisingly, the compliance costs associated with the existing obligations and the perceived lack of flexibility of those obligations are seen as the key costs imposed by the Code in this area. Having said that, however, it is not entirely clear as to how many master franchise systems are involved. In addition, there appears to be some debate as to how such costs are to be objectively measured and, in particular, which of these costs relate specifically to the Code. Importantly, there does not appear to be any comparison between the disclosure costs under the Code and those disclosure costs that would have been incurred by franchisors in the absence of the Code. Since it cannot be assumed that a franchisor did not incur disclosure costs before the introduction of the Code, it must follow that some disclosure costs would have been incurred irrespective of whether or not the Code had been mandated. Indeed, good franchisors have always provided appropriate disclosure to their franchisees.

Disclosure and master franchising: is there a need for change?

Clearly, the appropriateness or otherwise of the August 1999 proposals needs to be assessed by reference to the relative benefits and costs of the proposal, as opposed to the existing disclosure obligations within master franchise arrangements. Indeed, unless it can be shown that the August 1999 proposal can produce similar or greater benefits at a lower cost, there would be little justification in proceeding with that proposal. Similar considerations would apply in relation to other proposals in which master franchise arrangements are treated differently.

In considering a choice between maintaining the existing disclosure obligations and formulating more flexible disclosure obligations within master franchise arrangements, it is important to keep a number of guiding principles in mind:

- Franchisees should have access to information relevant to their system;
- Master franchise systems should not have to bear a disproportionately higher level of compliance costs than other franchise systems;
- The onus is on master franchise systems to demonstrate that there is sufficient justification for treating them differently from other types of franchise systems;
- There should be minimal or no duplication in the information provided to franchisees by the franchisor and subfranchisor/master franchisee; and
- Disclosure obligations must be certain, productive and cost-effective.

Within this context, the August 1999 proposal does allow franchisors a degree of flexibility in putting together a disclosure document. Such flexibility, however, brings with it a number of costs and benefits. Indeed, such flexibility would come at the expense of the present consistency of disclosure throughout the sector and may not be welcomed by some parts of the industry, and there are real doubts as to whether master franchise systems would take advantage of the flexibility offered by the proposal. In particular, given that the proposal places the onus of deciding what is materially relevant firmly on the franchisor, franchisors may, because of liability issues, be cautious to the extent of providing greater disclosure than they may feel necessary under the proposal.

Overall, therefore, it appears that the August 1999 proposal may not offer sufficient benefit in terms of a reduction of compliance costs associated with disclosure within master franchise arrangements. The level of uncertainty that may be introduced by the proposal, together with the dangers that such uncertainty presents for both franchisors and franchisees, would weigh against the proposal.

Ensuring cost effective disclosure: some alternatives

While adequate and timely disclosure is a central feature of the Code, it is important that such disclosure is achieved in a cost-effective manner. Indeed, the benefits of disclosure must be such as to outweigh the costs of that disclosure. Not only must a disclosure document provide meaningful information in a user-friendly manner, but that document must also be readily accessible to franchisees and potential franchisees. Needless to say, achieving these goals comes at a cost. There is the cost of implementing systems to collect the information, as well as the cost of dissemination. Both types of cost need to be carefully identified and managed. In doing so, franchise systems can secure the benefits of disclosure – informed decision-making by franchisees and lower incidence of disputes – in a way that is mindful of cost.

Clearly, there are a number of dimensions to the disclosure issue. In exploring such dimensions, valuable insights are provided as to the possible alternatives for dealing with disclosure under the Code. From the outset, there is the need to critically review the rationale for providing a disclosure document. What purpose does a document serve? Would it make business sense to provide a document in the absence of a requirement to do so? What information should the document contain? Faced with such questions, attention immediately turns to the link between the level of disclosure and the cost of that disclosure. Thus, the more information that is provided, the greater the cost of gathering and providing that information. Conversely, the less information that is provided, the greater the risk of disputation (and associated costs) as critical information is omitted.

Within this context, disclosure serves as a mechanism for assisting franchisees to assess the operation and viability of both the franchised business and the franchise system as a whole. Disclosure allows informed decision-making by franchisees and, in doing so, minimises the risk of misunderstandings. In this way, a disclosure document not only assists franchisees, but it assists the franchise system in laying the foundation for an open and transparent ongoing relationship with franchisees. Similarly, the disclosure document provides a franchise system with a very powerful tool with which to market itself. With franchise systems increasingly competing for good franchisees, a disclosure document can be effectively utilised in promoting the system and communicating with franchisees.

Given that disclosure documents do serve a valuable purpose, their provision has long been a feature of franchising. Good franchise systems have always provided a disclosure document in some form and, more importantly, have had the systems in place for generating such information. After all, the success of a business format franchise is very much tied to its ability to have a proven system for not only doing business, but also managing the informational needs of the franchise, particularly as it grows.

In view of the long standing rationale for disclosure within franchise arrangements, the question from a regulatory point of view becomes simply one of what types of information should, as a minimum, be included in a disclosure document. Needless to say, since some types of information are more useful than other types, this question requires that an assessment be made as to what information is critical to a franchisee, having regard to both the value of the franchised business and the cost of

providing the information. Indeed, while a franchisor should always be at liberty to provide more rather than less information if it chooses to do so, it may be appropriate within a regulatory context to consider the informational needs of franchisees against the monetary value of the particular franchised business.

With this in mind, there may be scope for having a range of disclosure options under the Code that is linked to the value of franchised businesses. Under one scenario already adopted, there would be recognition of the fact that as the value of the franchised business increases, franchisees have more at stake and, therefore, should have the benefit of greater disclosure. In short, while higher value franchised business could retain access to the comprehensive disclosure document currently required under the Code,[17] provision is made for a shortened disclosure document in the case of franchised businesses having a lower monetary value as judged by a predetermined benchmark. Significantly, this scenario applies to all franchise arrangements covered by the Code, rather than being limited to master franchise arrangements. While "low value" franchises are presently defined as those having an expected turnover of less than $50,000, there would be an expectation amongst franchising participants that that threshold be reviewed over time.

Variations on this scenario could include an exemption from disclosure in the case of very low value franchised businesses and/or an exemption in relation to very high value franchised businesses. Needless to say, while there may need to be appropriate safeguards in the case of low value franchised businesses, those involved in very high value franchised business should be in a position to independently demand disclosure.

A further dimension arises in those circumstances where other relevant mandatory industry codes or legislative provisions require the disclosure of information comparable to that required under the Code. While provision is already made under the Code for an exemption where a franchise agreement is covered by another mandatory industry code,[18] further provision could be made for an exemption where a franchisor is required by other legislative provisions to disclose information comparable to that required by the Code.

In short, the following scenarios arise:

- Further exemptions could, subject to appropriate safeguards, be provided under the Code in relation to very low and/or very high value franchised business;
- An exemption could be provided where a franchisor is required by other Federal, State or Territory legislative provisions to make disclosure of information comparable to that required by the Code; and
- A shortened disclosure document is provided in the case of relatively low value franchised businesses.

Of these possibilities, the first two would effectively remove the disclosure obligations imposed by the Code. Despite their appeal, however, these possibilities may not translate directly into lower disclosure costs for the franchise system. Indeed, in relation to both exempted franchised businesses and those instances where a franchisor is required by other legislative provisions to make disclosure, the franchisor would continue to have disclosure costs either because that is part of the price of attracting franchisees or simply because a legal obligation remains.

As for the third scenario, the question inevitably arises as to what should be included in a shortened disclosure document. In dealing with this issue, care must be taken to ensure that a shortened disclosure document provides information that still allows a franchisee to make an informed decision. Clearly, such information should not be provided out of context and should be meaningful. Importantly, the shortened disclosure document should provide information that a franchisee would not otherwise be able to obtain from the franchise agreement or related documents. Indeed, a distinction can be drawn between that information that can be gleaned from the franchise agreement or related documents, and that information which, because it is only known to the franchisor, cannot be obtained from other sources.

Given that there will be information that, while only known to the franchisor, will be critical to a franchisee's informed decision-making, it is appropriate for such information to be included in a shortened disclosure document. In identifying such information, the items of information currently

[17] See Annexure 1 of the Code.
[18] See cl 5(3)(b).

required by Annexure 1 of the Code provide a convenient starting point. Indeed, a shortened disclosure document could include those items in Annexure 1 that a franchisee could not otherwise obtain from the franchise agreement or related documents. As noted above, the items in the shortened disclosure currently include the cover page, and details about the franchisor, litigation, intellectual property, the franchise site or territory, marketing or other cooperative funds, payments, a franchisor's obligations, a franchisee's obligations, financial matters and the receipt of the disclosure document.[19] Significantly, provision has been made for a franchisee to seek the further information otherwise included in a full disclosure document, with the franchisor to provide the information unless it is reasonable to withhold it.

An evolving Code – 2001 amendments

Of the amendments made to the Code since its inception, those having come into force on 1 October 2001[20] are by far the most wide-ranging. Those amendments,[21] the result of the federal government's response to the 1999/2000 review of the Code by the government's Franchising Policy Council, impact on the Code's disclosure requirements, the concept of wholesale price as used in definition of franchise agreement, interaction with petroleum franchise legislation, requirements as to the auditing of marketing and cooperative funds, termination provisions and the dispute resolution framework. In addition, a number of minor technical amendments, intended to either further simplify the Code's language or update it to reflect changes in legislation referred to in the Code, were made.

Disclosure requirements – short-form disclosure

In its original form, the Code required that a full disclosure document as set out in Annexure 1 of the Code be provided to prospective franchisees;[22] a franchisee proposing to renew or extend a franchise[23] or, where requested in writing, by current franchisees.[24] Annexure 1 of the Code requires the full disclosure document to be set out in the following order:[25]

- Cover page;
- Franchisor details;
- Business experience;
- Litigation details;
- Payments to agents;
- Existing franchises;
- Intellectual property;
- Franchise territory;
- Supply of goods or services to a franchisee;
- Supply of goods or services by a franchisee;
- Sites or territories;
- Marketing or other cooperative funds;
- Payments;
- Financing;
- Franchisor obligations;
- Franchisee's obligations;
- Summary of other conditions of agreement;
- Obligations to sign related agreements;
- Earning information;
- Financial details;
- Updates;
- Other relevant disclosure information;
- Receipt.

Under the amendments, a distinction is now drawn between franchised businesses having an expected turnover of $50,000 or more, and those having an expected turnover of less than $50,000. The federal government sees such a distinction as an appropriate benchmark for dealing with industry concerns relating to the cost of complying with the Code's full disclosure requirements. Indeed, concerns have been expressed that in relation to low value franchises (especially within service industries) the cost of complying with the full disclosure requirements may impose a disproportionately higher compliance burden than on traditional business format franchises, which are often much larger investment propositions.

Thus, while a full disclosure document will still be required where the expected turnover is $50,000 or more, franchisors of businesses with an expected turnover of less than $50,000 now have the choice

[19] See the new Annexure 2 of the Code.
[20] See cl 2 of the Trade Practices (Industry Codes — Franchising) Amendment Regulations (No 1).
[21] See http://www.dewrsb.gov.au/smallBusiness/policy/franchisingCodeOfConduct/amendments.html
[22] See cl 6(1) of the Code.
[23] Ibid.
[24] See cl 19 of the Code.
[25] See cl 7 of the Code.

of either continuing to provide the full disclosure document or substituting a "short-form" disclosure document.[26] Under this short-form disclosure document – found in a new Annexure 2 – the information to be disclosed covers the following categories:

- Cover page;
- Franchisor details;
- Litigation;
- Intellectual property;
- Franchise site or territory;
- Marketing or other cooperative funds;
- Payments;
- Franchisor's obligations;
- Franchisee's obligations;
- Financial details;
- Receipt.

Under the new Annexure 2, franchisors of low value franchises are given a choice as to the amount of information they disclose. This choice, however, is subject to one very important potential qualification – where a short-form disclosure document is provided, a franchisee is able to request the additional information that would have otherwise been included in the full disclosure document. In those circumstances, the franchisor is to give that information, unless, in the circumstances, it is reasonable to withhold the information.[27] As has been a recurring theme under the Code, this proviso attempts to strike a balance between the interests of franchisors and franchisees. Indeed, the amendment seeks to minimise franchisor compliance costs while enabling franchisees to access information which either assists them to make informed choices or is material to the running of the franchised business.

Importantly, the ability to choose between a full disclosure document and a short-form document in appropriate instances gives rise to an ongoing challenge for franchisors of low-value franchises. In particular, they will need to carefully weigh up the relative advantages and disadvantages of using a short-form disclosure document. While the preparation of a short-form disclosure document will be less expensive than providing a full disclosure document, the question of how to manage requests for further information is one that must be addressed where short-form disclosure documents are used. Perhaps the clearest advantage of a short form-disclosure document is in those circumstances where a low-value franchise system is starting out and a full disclosure document is not yet available. Franchising activities can commence as soon as the short-form document is prepared. Similarly, a short-form disclosure document enables franchisors of low value franchises to streamline their disclosure practices, perhaps by making greater use of electronic disclosure as provided for by the amendments discussed below.

As for the ability of a franchisor providing a short-form disclosure document to withhold information that would otherwise have been included in the full disclosure document, the question clearly arises as to whether or not it would be reasonable to do so. Given the value the Code places on timely and adequate disclosure, there may be very few grounds on which to reasonably withhold the requested information. While frivolous or vexatious requests may be a ground for withholding information, it remains to be seen whether or not it will be necessary at some future point to specify a list of grounds on which it would be reasonable to withhold the information.[28] Within this context, franchisors using short-form disclosure documents will need to implement mechanisms for responding to requests for additional information as would otherwise be included in the full disclosure document. Once again, consideration may be given to electronic means as a way of minimising compliance costs.

Purpose of disclosure

It is noteworthy that the 2001 amendments include a new, expanded clause outlining the purpose of disclosure under the Code. The new cl 6A states:

> "6A Purpose of disclosure document
>
> The purposes of a disclosure document are:
>
> (a) to give to a prospective franchisee, or a franchisee proposing to enter into, renew or extend a franchise agreement, information from the franchisor to help the franchisee to make a reasonably

[26] See the new cl 6(2) of the Code.
[27] See the new cl 6C of the Code.
[28] Within this context, it is noteworthy that under cl 19(2) of the Code requests by existing franchisees for a current disclosure document are limited to one every 12 months.

informed decision about the franchise; and

(b) to give a franchisee current information from the franchisor that is material to the running of the franchised business."

This new purpose clause confirms that the Code is concerned with both pre-contractual disclosure and ongoing disclosure in specified circumstances. In relation to the latter there is (i) an existing obligation under cl 18 of the Code to provide disclosure of specific events not otherwise disclosed in the disclosure document; and (ii) an obligation under cl 19 to provide a copy of the current disclosure document where requested to do so in writing by an existing franchisee. This provision for limited ongoing disclosure represents an acknowledgment of the fact that a franchise relationship is a long-term one in which franchisees have a legitimate interest in accessing critical information regarding the operation of the franchise. Given the evolution of franchise systems it is quite likely that, over time, information contained in a pre-contractual disclosure document will date and, accordingly, may be of limited value to the ongoing operation of the franchised business.

Disclosure requirements – master franchising

The original disclosure obligations within a master franchising relationship have been affirmed by the 2001 amendments. In particular, there has been a slight re-wording of those provisions of the Code that originally dealt with disclosure obligations within a master franchising arrangement. The provisions – now found in a new cl 6B(2) – provide that:

"(2) If a subfranchisor proposes to grant a subfranchise to a prospective subfranchisee:

(a) the franchisor and subfranchisor must:

(i) give separate disclosure documents, in relation to the master franchise and the subfranchise respectively, to the prospective subfranchisee; or

(ii) give to the prospective subfranchisee a joint disclosure document that addresses the respective obligations of the franchisor and the subfranchisor; and

(b) the subfranchisor must comply with the requirements imposed on a franchisor by this Part.

Note A subfranchisor is also sometimes referred to as a master franchisee: see [cl] 3 (1)."

While a new cl 6B(1) continues to impose a disclosure requirement within the relationship between the franchisor and the master franchisee or subfranchisor, and the relationship between both the franchisor and master franchisee or subfranchisor and subfranchisee,[29] the new cl 6B(2) again spells out the nature of the disclosure requirements in the latter case. Significantly, the new cl 6B(2) reiterates the Code's original intention of ensuring that the ultimate franchisee receives either a joint disclosure document from the franchisor and subfranchisor, or a separate document from both of them. There has, for liability reasons, been a reluctance to provide a joint disclosure document. This remains a continuing challenge, particularly given the value of a joint disclosure document in terms of a providing a "one stop shop" for the provision of information.

For the sake of completeness, it should be noted that a new definition of master franchisee has been inserted in cl 3 of the Code:

"'master franchisee' or 'subfranchisor' means a person who is:

(a) a franchisee in relation to a master franchise; and

(b) a franchisor in relation to a subfranchise granted under the master franchise.

This new definition should be read together with existing definitions in cl 3(1) of such terms as "franchisee", "franchisor" and "master franchise". As noted above, the master franchise arrangements have prompted debate since the Code's inception and, in those circumstances, careful consideration has to be taken in balancing the respective interests of those involved in such arrangements.

Disclosure requirements – electronic offering of disclosure documents

The issue of whether or not a franchisor's obligations to provide a disclosure document may be satisfied through electronic means rather than through hard copies is one of considerable importance, particularly to the issue of compliance costs. In view of the clear cost advantages of

[29] The cl 3 definition of "franchisee" includes a person who otherwise participates in a franchise as a franchisee, a subfranchisor in its relationship with a franchisor and a subfranchisee in its relationship with a subfranchisor.

disseminating information electronically, the sector has explored the possibility of the Code's disclosure obligations being fulfilled through electronic means. Significantly, the issue of compliance cost has cross-industry significance as recognised by the federal government through the enactment of the *Electronic Transactions Act* 1999 (Cth). Within this context, particular regard is to be had to s 9(1) of the Act. It relevantly provides:

> "Requirement to give information in writing
> (1) If, under a law of the Commonwealth, a person is required to give information in writing, that requirement is taken to have been met if the person gives the information by means of an electronic communication, where:
> (a) in all cases – at the time the information was given, it was reasonable to expect that the information would be readily accessible so as to be useable for subsequent reference; and …
> (d) if the information is required to be given to a person who is neither a Commonwealth entity nor a person acting on behalf of a Commonwealth entity—the person to whom the information is required to be given consents to the information being given by way of electronic communication."

The ability, pursuant to this provision, to offer electronic disclosure is clearly drawn to the franchising sector's attention by the inclusion of a note at the bottom of cl 10 of the Code – Franchisor Obligations. That note states:

> "Subsection 9 (1) of the *Electronic Transactions Act 1999* provides that a requirement under a law of the Commonwealth to give information in writing is satisfied by giving the information electronically if it is reasonable to expect that the information will be readily accessible so as to be useable for subsequent reference, and the person to whom the information is given consents to it being provided electronically."

In view of the *Electronic Transactions Act*, franchisors will be able to offer a disclosure document electronically, provided that the document remains accessible (for example, as an archive file on the franchisor's computer system) and consent is obtained from those entitled to receive a document. In an era where electronic access to information is the norm, there are clear benefits for franchise systems operating in Australia to avail themselves of the ability to make disclosure documents accessible electronically.

In doing so, however, franchisors need to remain mindful of the importance of maintaining the security and integrity of electronic data and of taking every advantage of electronically recording the receipt of the disclosure document by those entitled to such documents under the Code. Thus, with effective use of electronic vehicles such as the internet and email, there may be considerable savings in costs associated with printing and disseminating both disclosure documents and materially relevant facts as required under cl 18 of the Code. With appropriate safeguards such as passwords and other security measures, the electronic dissemination of information can not only minimise costs, but also ensure the timeliness of disclosure. In addition, the use of electronic methods allows the franchise system to keep accurate records of the information having been sent to and received by the franchisee or prospective franchisee. In this way, the electronic dissemination of information becomes part of the franchise system's Code compliance strategy.

Disclosure requirements – modifications to full disclosure document

A number of changes have been made to the wording of various items in the Annexure 1 disclosure document. While many of these changes clarify some of the language or update references to legislation mentioned in the Annexure, others are more noteworthy. These include:

- An express requirement to include the signature of the franchisor, or of a director, officer or authorised agent of the franchisor on the cover page. [30] Significantly, this imposes a level of accountability on the person signing and should serve as a reminder that the person runs the risk of being directly liable for omissions or other misleading or deceptive conduct in relation to the document;[31]
- Further advisory comments being added to the document's cover page. These comments remind prospective franchisees that they are entitled to a 14 day waiting period in which to

[30] See also the new cl 6(2)(c) of the Code.
[31] See s 52 of the *Trade Practices Act*.

consider their decision to enter the franchise agreement and a seven day cooling off period after signing the agreement. These additional comments emphasis the fact that the prospective franchisee has both rights and obligations in relation to the franchise – whether they be expressed in the franchise agreement or in the Code. Once again, the onus, as illustrated by the content of the advisory comments on the cover page, is on prospective franchisees to carefully evaluate the franchise and be aware of their rights and obligations;

- In relation to the disclosure of financing arrangement, express reference is now to be made to any requirement that the franchisee must provide a minimum amount of unborrowed working capital for the franchised business, or meet a stated debt to equity ratio in relation to the franchised business;[32]
- Disclosure of the conditions of the franchise agreement that deal with obligations of the franchisor that continue after the franchised business ceases to operate;[33]
- Disclosure of any requirements under the franchise agreement for a franchisee to enter into an agreement under which the franchisee gains ownership of, or is authorised to use, any intellectual property;[34]
- In circumstances where financial reports are not provided, the inclusion of a copy of an audit report of a director's statement that the franchisor will be able to pay its debts;[35] and
- The inclusion of a statement in Item 23 of the document to the effect that the prospective franchisee may keep the disclosure document.[36]

Disclosure requirements – modifications to disclosure of materially relevant facts

In relation to the disclosure of materially relevant facts, the Code requires that if the disclosure document does not mention a matter listed in cl 18(2) of the Code, the franchisor is required to notify the franchisee or prospective franchisee of this within a reasonable time (not being more than 60 days). The rationale for this requirement being that there are some particularly significant developments impacting on a franchise that should be disclosed as soon as possible rather than simply included in the disclosure document when it is next updated.[37] The amendments will now also require changes in the intellectual property, or ownership or control of the intellectual property, that are material to the franchise system to be disclosed within a reasonable time.[38] This new inclusion is clearly explicable by the fact that intellectual property rights lie at the heart of the franchise relationship.

While as presently drafted, the Code requires that only those matters found in cl 18 are to be disclosed as a matter of urgency, the question may arise as to whether there should be a wider obligation to disclose, as they occur, material changes to all items to be covered in the disclosure document. This would involve a form of continuous disclosure that would recognise the ongoing financial inter-relationship between franchisors and franchisees. Similarly, the cost of dissemination could be minimal in view of the availability of electronic means for communicating information on material changes.

In practice, however, this dissemination of material changes may already occur amongst good franchisors. After all, open and ongoing two-way communication also lies at the heart of successful franchise relationships. In turn, that particular practices may already exist within the franchising sector would raise the much broader issue of whether the Code should encapsulate minimum standards of conduct, or industry or world best practice. Inevitably, questions of cost (even electronic communication has a cost associated with infrastructure and personnel) and timeliness of information would follow, particularly as there is an existing obligation to ensure that a disclosure document is updated at least once every financial year.

Finally, a mandatory requirement under the Code for wider continuous disclosure may be a moot

[32] See the new Item 14.2 of Annexure 1 of the Code.
[33] See the new Item 15.1(b) of Annexure 1 of the Code.
[34] See the new Item 18.1(ba) of Annexure 1 of the Code.
[35] See the new Item 20.3 of Annexure 1 of the Code.
[36] See the new Item 23 .1(a) of Annexure 1 of the Code.

[37] Under the new cl 6(1) of the Code, a franchisor must, within 3 months after the end of each financial year after entering into a franchise agreement, create a disclosure document for the franchise in accordance with the Code. In practice this will mean reviewing an existing document to ensure that it is up to date, as required previously under the now deleted cl 9(3) of the Code.
[38] See the new cl 18(2)(h) of the Code.

point in view of the prohibition under s 52 of the *Trade Practices Act* against misleading or deceptive conduct by franchisors. Indeed, s 52 will be a clear deterrent to having any out of date statements or omissions[39] in a disclosure document. As a matter of compliance with the *Trade Practices Act*, franchisors should be reviewing the contents of their disclosure document every time one is released to ensure that there are no statements or omissions that are misleading or deceptive or likely to mislead or deceive.

Disclosure requirements – removal of disclosure requirement on franchisee transferring franchise

Under the original cl 6(2) of the Code, a person proposing to transfer a franchise or a franchised business was required to give a disclosure document in accordance with the original Annexure 2 of the Code. Unlike the franchisor disclosure document under Annexure 1, the previous Annexure 2 disclosure document was limited to 4 items covering franchisee details, other relevant disclosure material, a disclaimer and a receipt. In view of the extremely limited value of this disclosure document, especially given that a prospective incoming franchisee would, in all likelihood be seeking much more information from the outgoing franchisee, it is not surprising that the requirement on transferring franchisees has been removed. Accordingly, the Code now focuses attention solely on a franchisor's obligation to disclosure information as required under the Code.

More importantly, the removal of the disclosure requirements on franchisees transferring a franchise has highlighted the existing obligation on franchisors to provide a disclosure document to a prospective franchisee. Given that cl 3(1) of the Code defines a prospective franchisee to mean a person who deals with a franchisor for the right to be granted a franchise, a franchisor who, for example, requires that its consent be obtained for a transfer of a franchise, may be held to be "dealing with" a person for the right to be granted a franchise. In those circumstances, that person would be a prospective franchisee for the purposes of the Code and therefore entitled to a disclosure document pursuant to cl 10 of the Code. In short, a franchisor will need to be mindful of its disclosure obligations in every instance in which it deals with a franchisee intending to take over an existing franchised business.

Definition of franchise agreement – wholesale price

Given that the definition of franchise agreement is central to the application of the Code, it is not surprising that the definition has come under intense scrutiny. One issue that has arisen is what is meant by "wholesale price" in cl 4 of the Code. This issue arises on the basis that if, for example, the only amount of money payable under an agreement is an amount for goods or services at or below their wholesale price, then the agreement is arguably not caught by the Code.[40] While the rationale for this is that the Code was not aimed at what could be called traditional distribution arrangements where a party acquires goods or services at a genuine arms length price for resale under his or her own name and in whatever manner he or she chooses, an issue arises where those otherwise covered by the Code structure their affairs in order to charge franchisees an amount that, while described as a wholesale price, is in fact an inflated amount to reflect the additional aspects of a franchise relationship.

In these circumstances, the amendments have inserted the concept of the "usual wholesale price" to affirm that any wholesale price should be a bona-fide or genuine wholesale price at which the goods or services are ordinarily sold.[41] Inevitably, the question of what is the "usual wholesale price" will be a question of fact, with careful consideration being given to what is the particular product or service being sold. Indeed, where a franchisor seeking to rely on the wholesale price exemption in cl 4(1)(d) sells goods or services to franchisees at wholesale prices higher than those offered to non-franchisees, then the question would arise as to whether the "wholesale" price being offered to franchisees is a genuine or the usual wholesale price. Clearly, where different wholesale prices are charged, care needs to be taken to ensure that such differences can be explained.

[39] Under s 4(2) of the *Trade Practices Act* a reference to conduct under the Act is to be read as a reference to the doing of or refusing to do any act.

[40] See cl 4(1)(d)(v) of the Code.

[41] See the new cl 4(1)(d)(v) of the Code. See also the new cl 4(1)(d)(vii) of the Code.

Interaction with petroleum franchise legislation

An issue that the amendments seek to address relates to the intended interaction between the Code and the *Petroleum Retail Marketing Franchise Act* 1980 (Cth). That issue arises on the basis that while the Code regulates franchises generally, the Act was introduced to regulate franchise agreements concerning specially the retail marketing of motor fuel. While any overlap was to be removed by the repeal of the Act and its replacement by a Mandatory Oil Code,[42] another prescribed Code under the *Trade Practices Act*, the Act remains as a result of concerns by the opposition parties in the Senate with the Government's downstream petroleum industry reform package.[43]

Given the overlap between the two laws, franchising participants in the petroleum retail sector have needed to have regard to their interaction. Within this context, the amendments have included a new purposes clause stating that in relation to franchise agreements concerning the retail marketing of motor fuel, the code is intended to operate concurrently with the *Petroleum Retail Marketing Franchise Act*.[44] Thus, to the extent possible the Code and the Act are to operate side by side. Where, however, there is an inconsistency, the question arises as to which would prevail. In those circumstances, consideration would need to be given to Parliament's intention, specifically that one is an Act exclusively dealing with petroleum retail franchises while the other is generic regulation intended to cover a range of franchise arrangements. On balance, Parliament is likely to have intended that a specific Act should prevail over a generic regulation in the event of an inconsistency.

Requirements regarding the auditing of marketing and cooperative funds

While cl 17 of the Code has required that franchise systems prepare and provide, where requested, audited financial statements for marketing or other cooperative funds into which franchisees are required to contribute, the clause has been silent on how the expenses associated with the preparation and audit of such funds are to be paid. In keeping with original expectations that such expenses were ordinarily to be met out of the relevant fund, a new cl 17(4) has been inserted stating that "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." While franchise systems will need to be mindful of what may constitute reasonable costs in the circumstances, it is now clear that franchisors will be able to deduct reasonable administration and audit costs from the fund itself.

Termination provisions

A modified cl 22(1) has been substituted for the previous clause to emphasise that a franchisor's power to terminate an agreement with a franchisee not in breach of the agreement must be one given by the agreement itself. The modified cl 22(1) provides:

"(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."

The proviso that the termination must be "in accordance with the agreement" has been inserted to avoid any suggestion that the previous cl 22(1) may have given the franchisor a statutory right to unilaterally terminate the agreement.

While the termination provisions have been largely untouched since the Code's inception, there may in time be issues concerning what a franchisee would see as an arbitrary termination by the franchisor, for example, for not agreeing to major changes to the franchise agreement. Notwithstanding that such allegations could be dealt with under the unconscionable conduct provisions of the *Trade*

[42] See Zumbo, "Petroleum Franchise Agreements and the Draft Oilcode: An Assessment" (1999) 1 *Franchising Law and Policy Review* 99.
[43] See Parliament of the Commonwealth of Australia, Senate Rural and Regional Affairs and Transport Legislation Committee, Report on the Provisions of the Petroleum Retail Legislation Repeal Bill 1998, June 1999.
[44] See the new cl 2(2) of the Code.

Practices Act,[45] or perhaps under an implied duty of good faith, there may be calls for express recognition for some form of compensation reflecting the balance of the franchise agreement where there is an arbitrary or without cause termination of the agreement.

Similarly, there may be calls from franchisors asking for the Code to acknowledge that repeated breaches of the franchise agreement by a franchisee should constitute a special circumstance under cl 23 of the Code enabling immediate termination of the agreement where that is provided for in the agreement. At present, a franchisor will need to allow the franchisee a reasonable time to remedy the breach (other than where cl 23 applies) after which if it has been remedied, the franchisor cannot terminate the agreement for that breach.[46] Given that compliance with the system is yet another key to the success of a franchise relationship, a franchisee that repeatedly breaches its obligations shows a lack of respect for those obligations, thereby not only jeopardising the franchise system but also the success of other franchisees.

Dispute resolution framework

The 2001 amendments deal with the following procedural aspects of mediation under the Code:

- a requirement that mediation under the Code be conducted in Australia.[47] This will ensure that mediation of franchising disputes is not frustrated by a contractual stipulation that mediation is to occur in a foreign jurisdiction. As the policy of the dispute resolution part of the Code is to promote the timely resolution of franchising disputes, such a policy would clearly be undermined by a contractual requirement that mediation take place overseas. Importantly, the requirement for mediation to take place within Australia does not, under the Code, extend to any other form of alternative dispute resolution that the parties may pursue in the event that the dispute remains unresolved following mediation under the Code. The parties would ordinarily be able to agree to alternative dispute processes, other than mediation, taking place outside Australia. With the growth of international franchising such dispute resolution clauses will increasingly be included in franchising agreements. More importantly, such clauses are, absent public policy reasons (such as unconscionability) against their enforcement in particular circumstances, likely to be given effect by the courts.[48]
- provision for the mediator, subject to mediation occurring in Australia, to decide the time and place for mediation.[49] While a mediator retains the ability to decide the time and place of mediation, the mediator can only decide a place within Australia; and,
- a provision to the effect that a party is taken to attend mediation if the party is represented at the mediation by a person who has the authority to enter an agreement to settle the dispute on behalf of the party.[50] Implicit in this amendment is the fact that the person attending the mediation is properly authorised to settle the dispute. Unless the person attending the mediation is properly authorised, the chances of a successful mediation will be greatly diminished, as no agreement can be reached without the unauthorised person having to defer, perhaps regularly, to the party they are representing.

A more significant addition to the dispute resolution part of the Code involves a new cl 30A dealing with termination of mediation. That new clause will apply where at least 30 days have elapsed after the start of mediation of a dispute and the dispute has not been resolved.[51] In those circumstances, the mediator must terminate the mediation if either party asks the mediator to do so.[52] This, however, does not prevent the mediator to terminate the mediation at any time.[53] The mediator may do so unless satisfied that a resolution of the dispute is imminent. Where the mediator terminates the mediation of a dispute under cl 30A, the mediator must issue a certificate stating the names of the parties, the nature of the dispute, that the mediation has finished, and that the dispute has

[45] See ss 51AA and 51AC of the Act.
[46] See cl 21 of the Code
[47] See the new cl 9(5A) of the Code.
[48] See *Timic v Hammock* [2001] FCA 74.
[49] See the new cl 29(5) of the Code.
[50] See the new cl 29(7) of the Code.
[51] See the new cl 30A(1) of the Code.
[52] See the new cl 30A(2) of the Code.
[53] See the new cl 30A(3) of the Code.

not been resolved.[54] The certificate is to be provided to the mediation adviser and each of the parties to the dispute.[55]

The new cl 30A acknowledges that there will be instances where mediation will be unsuccessful. In those circumstances, the status of the mediation needs to be clarified. Thus, where the mediation will not produce a resolution, that fact should be recognised and documented in the event that the matter progresses to litigation. In time, there may be a need to consider other alternative dispute resolution processes such as an industry ombudsman scheme or industry expert panel. Thought may also be given to the parties agreeing that any decision by an ombudsman or industry expert panel would be binding on them. After all, a decision handed down by a well-respected peer or group of peers should have wide industry acceptance, particularly as these mechanisms would provide an excellent vehicle to find "where the truth lies" in a particular dispute. Resolution of those disputes not resolved by mediation remains a challenge for the sector as a whole.

Assessing industry reaction to the Code

As part of the 1999/2000 Code review, the OSB commissioned a survey to assess the industry's response to the Code.[56] In particular, this survey was concerned with the extent to which the Code was adequately delivering on its objectives whilst being responsive to both franchisor and franchisee business needs. In dealing with this question, the survey focussed on such issues as:

- the extent to which the Code had generated awareness amongst the franchise parties and had been understood by them;
- the extent to which the Code had been useful in providing a cost-effective and speedy process for dealing with complaints and disputes;
- the extent to which compliance with the Code had changed the operating procedures of franchise systems and the range of costs incurred in the franchising industry; and
- the extent to which the Code provides better information to franchisees to enable them to make an informed decision about investing in a franchise.[57]

Extent to which the Code had generated awareness amongst the franchise parties and had been understood by them

Of the franchisors surveyed, over 95% were aware of the Code.[58] Significantly, while 58.4% of franchisors felt that the Code was relevant to the industry, a combined total of 57.9% of franchisors surveyed felt that the Code was still lacking in terms of its understandability, relevance to the issues affecting the industry, or effectiveness in its implementation.[59] Of the 57.9% of franchisors that believed some change was necessary, 37.6% nominated the area of understandability, 10.4% nominated relevance and 9.9% nominated effectiveness as the areas requiring change.[60] In short, although a majority of franchisors are in support of the Code, a similar majority considered that there was room for improvement of the Code in terms of understandability, relevance or effectiveness.

In contrast to the very high level of franchisor awareness, the survey revealed that the level of awareness amongst franchisees was significantly lower, at over 75% of franchisees surveyed.[61] Interestingly, with 76.3% of franchisees making no comment either in support or against the Code, 14.4% of franchisees surveyed suggested that the Code was helpful, and 9.3 % of franchisees felt the Code was not helpful or relevant.[62]

Such findings demonstrate that while almost all of the franchisors surveyed were aware of the Code, 25% of franchisees surveyed were not aware of the Code. In such circumstances, it is readily apparent that from a franchisor perspective industry education has been very effective and, by implication, has ensured that franchisors have been alert to the Code's development and implementation. Given that the Code obligations fall essentially on franchisors, such very high levels of franchisor awareness should translate into an

[54] See the new cl 30A(4) of the Code.
[55] See the new cl 30A(5) of the Code.
[56] *The 1999 National Survey of Perceptions of the Franchising Code of Conduct*, prepared for the Federal Office of Small Business by Lawler Davidson Consultants.
[57] Ibid, 8-9.
[58] Ibid, p 23.
[59] Ibid, p 24.
[60] Ibid, p 25.
[61] Ibid, p 23.
[62] Ibid, p 26.

equally high level of comp liance with the Code.

From a franchisee perspective, some work remains to be done to raise the level of awareness to that shown by franchisors. Indeed, while currently at a high level, there is no reason why the level of franchisee awareness should not be comparable to that of franchisors. Nevertheless, the overall high levels of awareness amongst industry participants augur well for constructive ongoing industry consultation.

As for industry perceptions of the Code, the survey points to a majority of franchisors being in support of the Code. Having said that, however, there is majority support amongst franchisors for fine-tuning the Code in particular areas. Similarly, while the survey's inconclusiveness in relation to overall franchisee perceptions of the Code may be explained by franchisees being content with the present Code, it may also suggest that franchisees are adopting a "wait and see" approach to the Code. Either way, the area of franchisee perceptions of the Code is certainly an area to be looked at closely, particularly as franchisees are the intended primary beneficiaries of the Code.

In the meantime, it is worth noting that while an earlier survey[63] found that 82% of the franchisees surveyed were aware of the Code,[64] it also found that 50% of the franchisees surveyed indicated that they believed the Code to be a useful document.[65] This earlier survey not only reaffirms the scope for promoting greater awareness of the Code amongst franchisees, but also suggests that a significant percentage of franchisees consider the Code to be useful.

Extent to which the Code had been useful in providing a cost-effective and speedy process for dealing with complaints and disputes

Of the franchisors surveyed, 25% claimed that they had experienced some levels of disputation since July 1998.[66] Of these disputes, 12.4 % related to payment of fees, 4% related to a misunderstanding in the offer and sale of the franchise, 3.0 % related to product or service supply, 3.0% related to support training and other assistance, and 2.5% related to the amount of fees.[67] Importantly, most franchisors that had experienced disputes had been able to resolve their problems through discussion (7.4%) and mediation (6.4%) as opposed to legal or court action (5.4%).[68] Finally, of those franchisors involved in disputes, 9.4% claimed the dispute had negligible effects on their profitability, 4.5% claimed that the dispute put dents in their profits for a month, 5.9% claimed to have suffered dents in their profits for a year, and 2.0% claimed that their viability was affected.[69]

Of the franchisees surveyed, 10% of franchisees claimed they had experienced some levels of disputation.[70] Significantly, it should be noted that some of these franchisees were involved in disputes involving more than one issue. The following outlines the range of issues and the percentage of franchisees involved:

- misrepresentation in the offer and sale of the franchise (3.2%);
- misconduct in the ongoing franchise relationship (4.7%);
- efforts to improperly terminate the relationship (1.2%);
- product or service delivery (4.7%);
- payment of fees (3.4%);
- support training and other assistance (2.8%); and
- competition over sites/areas (3.2%).[71]

As for the impact of these disputes on those franchisees involved, 2.8% claim to have experienced negligible effects, 1.4% claim the dispute put dents in their profits for a month, 2.6% claim to have suffered dents in their profits for a year and 2.4% claim their viability was affected.[72] In terms of dispute resolution, the survey also revealed that most franchisees that had experienced disputes were able to resolve their problems through

[63] *Survey of Small Business Attitudes and Experience in Disputes and their Resolution – Report*, prepared for the Commonwealth Attorney-General's Department by Marsden Jacob Associates, Transformation Management Services and Brian Sweeney & Associates, April 1999.
[64] Ibid, p 51.
[65] Ibid.
[66] *The 1999 National Survey of Perceptions of the Franchising Code of Conduct*, prepared for the Federal Office of Small Business by Lawler Davidson Consultants, p 27.
[67] Ibid, p 28.
[68] Ibid, p 29.
[69] Ibid.
[70] Ibid, p 27.
[71] Ibid, pp 29-30.
[72] Ibid, p 30.

discussion and mediation (7.4%) as opposed to legal or court action (0.8%).[73]

Overall, the survey found that in relation to the dispute resolution mechanisms franchisors were significantly more knowledgeable than franchisees.[74] For example, while 73.8% of franchisors surveyed were aware of the existence of the Office of the Mediation Adviser, the level of awareness amongst franchisees was much lower at 40.3% of those surveyed.[75]

Extent to which compliance with the Code had changed the operating procedures of franchise systems and the range of costs incurred in the franchising industry

In relation to compliance with the Code, the survey dealt separately with disclosure practices and the drafting of franchise agreements. On the issue of disclosure, although 27.7% of franchisors surveyed had not redeveloped their disclosure document, a significant majority – 66.3% of franchisors surveyed – claimed that the Code had caused their system to alter its disclosure practices.[76] Interestingly, the survey found that the older the franchise system, the more likely that it was to change its disclosure practices.[77] Indeed, while 50% of franchise systems in business less than three years claimed to have altered disclosure practices, the relevant percentages for franchise systems in business between three and five years, and those in business over five years were 65% and 69% respectively.[78]

Turning to the cost of complying with the Code's disclosure requirements, 32.2% of franchisors surveyed claimed not to have incurred any expenses, while 31.2% claimed to have incurred costs amounting to less than 1% of their annual turnover.[79] A further 27.7% claimed that they had incurred costs greater than 1% of their annual turnover.[80] In short, 63.3% of franchisors surveyed either incurred no cost or relatively small costs when complying with the Code's disclosure requirements. Within this context, the use of turnover as the measure of cost is significant, as it not only reinforces the point that for a franchise system disclosure is part of doing business, but it also provides a way of objectively comparing costs across the industry.

As for the impact of the Code on the drafting of franchise agreements, 63.9% of the franchisors surveyed claimed that the Code had caused their system to alter its franchise agreement.[81] Of these franchisors, the majority – 54.5% of the franchisors surveyed – indicated that such alternations were made to comply with the Code's dispute resolution requirements.[82] The remaining 9.4% indicated that changes were made to take account of the Code's requirements in relation to termination of franchise agreements.[83]

When taken together, these findings are noteworthy for they not only suggest that the Code is imposing negligible or relatively minor compliance costs on the franchising sector, but that the Code has seen a change in the disclosure practices of a large percentage of franchise systems. Given that a sizable percentage (27.7%) of franchise systems did not have to change their disclosure practices, the change in the disclosure practices of a significant percentage of franchise systems would tend to suggest that the Code has brought about a high level of consistency in disclosure documents.

Finally, the relatively higher number of older franchise systems needing to alter disclosure practices to comply with the Code could also suggest that these systems have used the implementation of the Code as an opportunity for reviewing and/or updating their disclosure practices. While such a review and/or updating of disclosure practices may have been prompted by the Code's introduction, it would be trite to say that good franchisors would, quite apart from the Code's requirement to update the disclosure document,[84] continue to regularly review their disclosure practices.

[73] Ibid.
[74] Ibid.
[75] Ibid.
[76] Ibid, p 31.
[77] Ibid.
[78] Ibid, pp 31-32.
[79] Ibid, p 33.
[80] Ibid.
[81] Ibid, p 32.
[82] Ibid.
[83] Ibid.
[84] See the new cl 6(1).

Extent to which the Code provides better information to franchisees to enable them to make an informed decision about investing in a franchise

On the question of how effective the Code has been in providing franchisees with useful information, the survey found that while 29.8% of franchisees surveyed described the disclosure document as useful or very useful, over 46% of those franchisees surveyed did not offer a comment.[85] As for reasons why the disclosure document was considered useful, 25.9% of franchisees surveyed claimed that the document provided good business guidance and a general reference point, particularly in the event of a dispute.[86]

As for the use made of the disclosure document when entering into a franchise agreement, 25.9% of franchisees surveyed described the document as either important or very important, while 27.7% described it as not important.[87] Once again, over 46% of those franchisees surveyed did not offer a comment.[88]

Such relatively low response rates in relation to the usefulness of the Code's disclosure requirements may be in keeping with a perception amongst franchisees that there is scope for making the Code more understandable, easier to use and generally more effective.[89] In particular, there may be scope for including a plain English summary of the Code as a preface to the Code, adding explanatory material throughout the Code and regularly reviewing the informational needs of franchisees. After all, disclosure under the Code can only be cost effective if it provides franchisees with information they find useful or could not otherwise obtain.

Observations on the Code's operation and effectiveness

The survey highlights not only the areas in which the Code has had a positive impact, but also those areas requiring further attention. Indeed, although the survey found a very high level of awareness of the Code amongst franchisors surveyed, it also found that there was scope for improving the level of awareness amongst franchisees. Similarly, the survey found considerable scope for improving the levels of awareness amongst both franchisors and franchisees in relation to the Office of the Mediation Advisor. While these gaps in the levels of awareness may be related to the relatively short time since the Code's implementation and the survey, they do reveal the need to consider various mechanisms for ensuring that awareness levels are improved and/or maintained at very high levels.

Such mechanisms include:

- providing summaries of the Code or single page fact sheets of key aspects of the Code. Such summaries or fact sheets would be drafted in user friendly language with relevant examples being used to highlight the key aspects of the Code. They could be provided in various community languages and be disseminated by industry and community groups, through direct mail outs to franchising participants and at business and investment expositions. The summaries or factsheets could be distributed individually or collated together into a self-contained educational package;
- ongoing education campaigns by industry and government. Such ongoing campaigns would build on the significant resources devoted to the education campaigns at the time of the Code's introduction. These educational initiatives could be supported by user-friendly materials and be conducted in regional centres around Australia; and,
- a one-stop website dedicated to the Code. This website would be widely advertised and over time would become a reference point for all franchising participants. While information on the Code is currently available on a number of websites, a one-stop website would be advantageous in that franchising participants would only need to remember one internet address. Key information would be available on the website and, where appropriate, may be presented from both a franchisor and franchisee perspective. Such one-stop websites are already in operation in relation to consumer

[85] *The 1999 National Survey of Perceptions of the Franchising Code of Conduct*, prepared for the Federal Office of Small Business by Lawler Davidson Consultants, p 37.
[86] Ibid. See also Appendix 3.
[87] Ibid.
[88] Ibid.
[89] Ibid.

protection,[90] country of origin labelling,[91] the consumer credit code,[92] and product safety recalls.[93]

The provision of summaries or fact sheets and a dedicated website could, when combined with other appropriate educational strategies, also assist in promoting alternative dispute resolution processes within the franchising sector. Indeed, the wider the understanding of such processes amongst franchising participants, the greater the likelihood of their adoption in the resolution of franchising disputes. After all, while the Code currently provides for the use of mediation in the event of a stalemate between the parties in dispute,[94] the parties do have scope to come to an agreement about how to resolve a dispute before moving to mediation.[95] Within this context, a wider awareness of alternative dispute resolution processes within the franchising sector would allow the parties to better explore the range of processes and settle upon the process that best meets their needs.

While promoting a greater awareness of the Code and alternative dispute resolution processes will go a long way towards ensuring the Code's continued relevance to franchising arrangements, it is important that the Code is perceived as striking an appropriate balance between the needs of franchisors and franchisees. Indeed, unless the Code is perceived by franchising participants as being balanced, there is a real risk that support for the Code, particularly amongst franchisees, will fall, possibly bringing with it calls for franchising specific legislation. In such circumstances, general comments offered by those surveyed are noteworthy, for they suggest that although franchisors perceive the Code as more effective and useful than franchisees, the latter tended to see the Code as tilted towards franchisor needs.[96] While such comments are in keeping with the perception amongst many of those surveyed that the Code could be made more reader friendly, relevant and comprehensive in its coverage,[97] they do reinforce the importance of having a Code that is balanced and responsive to the needs of franchising participants generally.

Conclusion

Although the adoption of a new regulatory framework for Australian franchising has brought with it a range of challenges for the sector, it is apparent that the sector has, in general, responded favourably to the Code. Not only has extensive industry consultation taken place before and after the Code's introduction, but more importantly, every opportunity has been taken by industry participants and associations to contribute to the development and fine-tuning of the Code. Effective use has been made of the internet and promotional activities in generating a high level of industry consultation in relation to the Code. In doing so, the Code has introduced a set of minimum standards, while remaining sufficiently flexible as a regulatory framework to evolve over time.

[90] See http://www.consumersonline.gov.au/
[91] See http://www.isr.gov.au/labelling/
[92] See http://www.creditcode.gov.au/
[93] See http://recalls.consumer.gov.au/
[94] See cl 29(3).
[95] See cl 29(2)

[96] *The 1999 National Survey of Perceptions of the Franchising Code of Conduct*, prepared for the Federal Office of Small Business by Lawler Davidson Consultants, p 39.
[97] Ibid, p 40.

Unconscionable conduct and codes of conduct

Editor: Frank Zumbo

COMMERCIAL UNCONSCIONABILITY AND RETAIL TENANCIES: A STATE AND TERRITORY PERSPECTIVE

After a decade of debate, it is perhaps not surprising that the issue of how best to deal with allegations of unconscionable conduct in retail tenancies still remains unresolved. While of course there has been the enactment of s 51AC of the *Trade Practices Act 1974* (Cth) (the Act) and a number of equivalent State and Territory initiatives, it is readily apparent that these State and Territory initiatives are not exact replicas of s 51AC. Indeed, a review of these initiatives reveals clear differences between the provisions. Such differences are particularly noteworthy for not only pointing to an ongoing debate as to the appropriate wording of a statutory provision dealing with unconscionable conduct within retail tenancies, but also adding another level of complexity to the debate. Thus, irrespective of whether or not the differences are justifiable, such differences do raise the question of whether a new attempt should be made to bring about uniformity in State and Territory provisions dealing with unconscionable conduct.

In turn, the question also arises as to whether or not uniformity in State and Territory provisions dealing with unconscionable conduct is sufficient to address the broader concerns that landlords and tenants may have regarding the fairness or otherwise of clauses of a retail lease. This broader question is no doubt related to the growing realization that existing State and Territory provisions dealing with unconscionable conduct are limited by the judicial tendency to give them a procedural unconscionability bias with little ability for tenants to bring actions based solely on the alleged substantive unfairness of a clause of a retail lease.[1] In short, it would appear that unless a landlord or tenant can establish some judicially recognized form of procedural unconscionability, the tenant is generally unable to rely on s 51AC or its State and Territory equivalents to challenge a clause of a retail lease that goes beyond what is reasonably necessary to protect the legitimate interests of the party seeking to rely on the term.

Within this context, it is opportune to not only consider the scope and operation of existing State and Territory provisions dealing with unconscionable conduct but also to explore the question of whether or not there is a need for a new regulatory model for dealing with allegedly unfair clauses in a retail lease. In doing so, this report will begin by considering the operation of the New South Wales provision as a case study of how s 51AC may be drawn down by a State or Territory. Having considered the operation of the New South Wales provision the report will move to consider a number of significant differences between the various State and Territory legislative provisions dealing with unconscionable conduct within a retail context. Importantly, such differences relate to the *application* of the State and Territory based provisions and the factors that can be taken into account when dealing with claims under those provisions. Finally, the report will consider future directions in dealing with allegedly unethical conduct within a retail tenancy context as well as allegedly unfair clauses in retail leases.

THE NEW SOUTH WALES EXPERIENCE: A CASE STUDY IN THE DRAWING DOWN OF SECTION 51AC

While the enactment of s 51AC of the Act was intended to lead the way in the enactment of a new statutory notion of unconscionable conduct, there emerged an expectation that the States and Territories would replicate or "draw down" the section into their retail tenancy legislation with a view to not only overcoming any constitutional limitations of s 51AC, but also allowing landlords and tenants access to State and Territory based dispute resolution processes and Tribunals.[2] One State to

[1] See Zumbo F, "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" (2005) 13 TPLJ 70.

[2] See generally comments made in Department of Industry, Tourism and Resources, *New Deal: Fair Deal – The Federal*

draw down s 51AC was New South Wales. This drawing down was achieved through amendments[3] to the *Retail Leases Act 1994* (NSW) which came into effect on 12 October 2001. Those amendments gave the New South Wales Administrative Decisions Tribunal (the Tribunal) the power to consider allegations of unconscionable conduct within New South Wales retail tenancies. That power – based on the statutory notion of unconscionable commercial conduct found in s 51AC and now adopted in s 62B of the *Retail Leases Act* – enables the Tribunal to have regard to whether or not the alleged conduct is, all the circumstances, unconscionable.

APPLICATION OF SECTION 62B

While s 62B applies to a retail shop lease covered by the *Retail Leases Act* and entered into after that Act's commencement, the provision also applies to retail shop leases entered into before that Act commenced, provided that those leases would have been covered by that Act if they had been entered into after its commencement. This extended application of s 62B is dependent on whether the lease is of a type that, had it been entered into after the commencement of the *Retail Leases Act*, it would not have been excluded by the operation of s 6 of that Act.[4] Once it is determined that the lease is one to which s 62B applies, it becomes necessary to establish that the conduct has occurred on or after the 12 October 2001, since s 62B does not apply to conduct occurring before that date. Where the conduct occurs on or after 12 October 2001, and is in connection to a retail shop lease to which s 62B applies, the relevant party suffering loss or damage by reason of unconscionable conduct can invoke the jurisdiction of the Tribunal.

SCOPE OF SECTION 62B

Like s 51AC, s 62B prohibits conduct that is in all the circumstances unconscionable. The reference to "all the circumstances" emphasises that the conduct is to be judged by reference to its context, rather than by reference to the more limited equitable notions of unconscionability. While no doubt a person within the equitable doctrine of unconscionability would have the benefit of provisions such as ss 51AC and 62B, it is clear that a wider range of conduct is intended to face scrutiny under both these sections. With this in mind, s 62B prohibits both a lessor[5] and lessee[6] from engaging in unconscionable conduct in connection with a retail shop lease.[7] Like s 51AC, a list of matters that the Tribunal may take into consideration in assessing allegations of unconscionable conduct under the provision has also been provided, namely:

Government's Fair Trading Statement – Giving Small Business a Fair Go (1997), http://www.industry.gov.au/assets/documents/itrinternet/OSB_fairtrading_sept_1997.pdf viewed August 2006.

[3] See *Retail Leases Amendment Act 1998* (NSW).

[4] *Retail Leases Amendment Act 1998* (NSW), s 6 provides:

(1) This Act does not apply to any of the following leases of retail shops:
  (a) (Repealed)
  (b) leases for a term of 25 years or more (with the term of a lease taken to include any term for which the lease may be extended or renewed at the option of the lessee),
  (c) leases entered into before the commencement of this section,
  (d) leases entered into under an option granted or agreement made before the commencement of this section,
  (e) any other lease of a class or description prescribed by the regulations as exempt from this Act.

(2) This Act does not apply to any lease referred to in this section that is assigned to another person after the commencement of this section.

Note: Part 9A provides for certain exemptions regarding Sydney (Kingsford-Smith) Airport.

[5] Under s 3 of the *Retail Leases Act 1994* (NSW), a lessor is defined as the person who grants or proposes to grant the right to occupy a retail shop under a retail shop lease, and includes a sublessor and a lessor's or sublessor's heirs, executors, administrators and assigns.

[6] Under s 3 of the *Retail Leases Act 1994* (NSW), a lessee is defined as the person who has the right to occupy a retail shop under a retail shop lease, and includes a sublessee and a lessee's or sublessee's heirs, executors, administrators and assigns.

[7] Under s 3 of the *Retail Leases Act 1994* (NSW), a retail shop lease is defined to mean any agreement under which a person grants or agrees to grant to another person for value a right of occupation of premises for the purpose of the use of the premises as a retail shop: (a) whether or not the right is a right of exclusive occupation, and (b) whether the agreement is express or implied, and (c) whether the agreement is oral or in writing, or partly oral and partly in writing.

(a) the relative strengths of the bargaining positions of the lessor and the lessee, and
(b) whether, as a result of conduct engaged in by the lessor, the lessee was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the lessor, and
(c) whether the lessee was able to understand any documents relating to the lease, and
(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the lessee or a person acting on behalf of the lessee by the lessor or a person acting on behalf of the lessor in relation to the lease, and
(e) the amount for which, and the circumstances under which, the lessee could have acquired an identical or equivalent lease from a person other than the lessor, and
(f) the extent to which the lessor's conduct towards the lessee was consistent with the lessor's conduct in similar transactions between the lessor and other like lessees, and
(g) the requirements of any applicable industry code, and
(h) the requirements of any other industry code, if the lessee acted on the reasonable belief that the lessor would comply with that code, and
(i) the extent to which the lessor unreasonably failed to disclose to the lessee:
  (i) any intended conduct of the lessor that might affect the interests of the lessee, and
  (ii) any risks to the lessee arising from the lessor's intended conduct (being risks that the lessor should have foreseen would not be apparent to the lessee), and
(j) the extent to which the lessor was willing to negotiate the terms and conditions of any lease with the lessee, and
(k) the extent to which the lessor and the lessee acted in good faith.

Under s 62B(4), a comparable set of matters applies in relation to a lessee and may be considered by the Tribunal for the purpose of determining whether a lessee has contravened s 62B(2).

As for the nature of the conduct that will be considered unconscionable under the new s 62B, it is useful to refer to the decision in *ACCC v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253; [2000] FCA 1365. While this was a case in which allegations of unconscionable conduct were established within a franchising context, the comments by Sundberg J in the case provide insight in relation to commercial unconscionability cases generally. In particular, his Honour pointed (at 270) to an overwhelming case of unreasonable, unfair, bullying and thuggish behaviour by the franchisor in relation to each franchisee as establishing unconscionable conduct in contravention of s 51AC(1). This behaviour included competing with the franchisees; refusing to supply products for (on at least two occasions) contrived reasons or unless certain conditions were met; omitting the franchisees' names from brochures advertising the product range, while providing contact details for the franchisor; refusal to negotiate on or discuss issues of concern to the franchisees; and the hostile and pugnacious manner in which the franchisor generally behaved towards to the franchisees, were all factors suggestive of unconscionable conduct in the circumstances.[8]

CONDUCT NOT TO BE CONSIDERED UNCONSCIONABLE

Two actions are identified as types of conduct not in themselves to be taken as constituting unconscionable conduct for the purposes of s 62B of the *Retail Leases Act*. These are outlined in s 62B(5) and (6):

(5) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with a retail shop lease by reason only that the first-mentioned person institutes legal proceedings in relation to that lease or refers to arbitration a dispute or claim in relation to that lease.
(6) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with a retail shop lease by reason only that the first-mentioned person fails to renew the lease or issue a new lease.

In addition to these two provisos, s 62B(7) provides that the Tribunal is not to have regard to circumstances not reasonably foreseeable at the time of the alleged breach of conduct engaged in before the provision's commencement.

[8] *ACCC v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253 at 267-269; [2000] FCA 1365.

The distinction between circumstances existing and conduct occurring before the provision's commencement has been an issue considered with respect to s 51AC. Significantly, the issue arose in a s 51AC case brought by the Australian Competition and Consumer Commission (ACCC) within a retail tenancy context. In that case – *ACCC v Leelee Pty Ltd* [2000] ATPR 41-742; [1999] FCA 1121 – Mansfield J made the following remarks regarding the distinction between circumstances and conduct for the purposes of s 51AC (at 40,603):

> in determining whether an alleged contravention of s 51AC(1) of the Act has occurred, the Court cannot take into account conduct on the part of the alleged contravener, using the term "conduct" in the wide sense in which it is defined in s 4(2) of the Act. It follows, in my judgment, that the applicant ought not be permitted to make allegations of conduct on the part of the respondents prior to 1 July 1998 in the statement of claim.
>
> That does not indicate where the borderline between "circumstances" and "conduct" lies. Yet, borderline there must be. There may clearly be matters relevant to an alleged contravention of s 51AC(1) of the Act which do not involve any conduct on the part of the alleged contravener, and which arose before 1 July 1998. Where they provide the context in which an alleged contravention is sought to be proved, there is nothing to indicate that those matters might not be alleged and proved. There may also be matters which involve some act done or transaction entered into by an alleged contravener prior to 1 July 1998 which provide the content in which the alleged contravention occurred. Such matters may well be "circumstances" under s 51AC(6)(b). An illustration in the present claim may be Leelee's lease of the premises, and its underlease of the stall to the Choongs. Another illustration may be the fact of Mr Ong's directorship of Leelee. Although, in a sense, each of those matters involves conduct because Leelee had to act to accept the lease and grant the underlease, and Mr Ong had to give his consent to be a director of Leelee, I do not think that that is the sort of conduct to which s 51AC(6)(b) refers. That is because the definition of conduct, and of engaging in conduct, in s 4(2) of the Act, although widely expressed, serves the purpose of identifying behaviour which may relate in some way to a potential contravention of a provision of the Act. In the present matter, the fact of the underlease (for example) is not related in that way to the alleged infringement but provides the setting in which the alleged infringement occurred.

At its simplest, his Honour's comments would suggest that a party seeking to rely on s 62B can allege and prove matters (such as the existence of a lease) that provide the setting for an alleged breach of the provision, but cannot introduce evidence pointing to an alleged breach before 12 October 2001.

THE ROLE OF NEW SOUTH WALES ADMINISTRATIVE DECISIONS TRIBUNAL

The New South Wales Administrative Decisions Tribunal is given jurisdiction under the *Retail Leases Act* to hear a "unconscionable conduct claim".[9] Where a victim of unconscionable conduct prohibited by s 62B suffers loss or damage by reason of that conduct, s 62B(8) allows that person to make a claim for that loss or damage through the Tribunal:

> (8) A lessor or lessee, or former lessor or lessee, who suffers loss or damage by reason of unconscionable conduct of another person that is in contravention of this section may recover the amount of the loss or damage by lodging a claim against the other person under section 71A.

The lodging of an unconscionable conduct claim is dealt with under s 71A of the Act:

> 71A Lodging of unconscionable conduct claims with Tribunal
>
> (1) A lessor or lessee, or former lessor or lessee, under a retail shop lease or former retail shop lease may lodge an unconscionable conduct claim with the Tribunal for determination of the claim.
>
> (2) A claim may not be lodged more than 3 years after the alleged unconscionable conduct occurred.
>
> (3) In this section:
>
> *lessor* or *lessee* under a retail shop lease or former retail shop lease includes a person who is a guarantor or covenantor under a lease or former lease.

This three-year limitation period can be extended by the Tribunal under s 71B(2) and (3) of the *Retail*

[9] Under s 70 of the *Retail Leases Act 1994* (NSW), an "unconscionable conduct claim" is defined to mean a claim for relief under s 62B.

Leases Act:

71B Lodging of claims after 3 years

…

(2) An unconscionable conduct claim may be lodged more than 3 years but no later than 6 years after the alleged unconscionable conduct occurred, if the Tribunal orders that the claim may be lodged with the Tribunal.

(3) The Tribunal may make an order under this section:

(a) on application by the party or former party concerned, and

(b) after hearing such of the persons likely to be affected by the application as it sees fit, and

(c) if the applicant satisfies the Tribunal that it is just and reasonable to make the order.

The Tribunal's powers in relation to unconscionable conduct claims are outlined in s 72AA of the *Retail Leases Act*. Essentially, the Tribunal is empowered to make orders in relation to the payment or non-payment of money and to make such ancillary orders as are needed to give effect to those orders.

Under s 73 the Tribunal is restricted to making orders up to a total value of $400,000. Where the loss or damage suffered is greater than that amount, consideration may need to be given to commencing, where possible, actions under s 51AC of the Act where no monetary limit applies to damages recoverable from conduct covered by s 51AC.[10]

Finally, matters involving an unconscionable conduct claim can be transferred to the New South Wales Supreme Court under s 76A of the *Retail Leases Act*. Overall, therefore, it is readily apparent that s 62B of the *Retail Leases Act* enables allegations of unconscionable conduct within New South Wales retail tenancies to be dealt with in a forum perceived to be more accessible to landlords and tenants than is a judicial forum such as the Federal Court in s 51AC matters. Clearly, this access to a timely and low cost dispute resolution process has been a key motivation behind giving a State-based tribunal like the New South Wales Administrative Decisions Tribunal jurisdiction over unconscionable commercial conduct claims.

STATE AND TERRITORY PROVISIONS DEALING WITH UNCONSCIONABLE CONDUCT: KEY DIFFERENCES

Turning to the other State and Territory provisions dealing with unconscionable conduct within retail tenancies, it is readily apparent that not only are there some important differences between these State and Territory provisions, but that these provisions are in a number of respects substantively different to s 51AC. Indeed, apart from being modified to fit a retail tenancy context, a number of State and Territory provisions have gone further than s 51AC. For example, the Australian Capital Territory and Tasmania provisions have included the term "harsh" in describing the conduct covered by the provision. In the case of the Australian Capital Territory's provision, the term "harsh" has been joined by the term "oppressive." Thus, s 22 of the *Leases (Commercial and Retail) Act 2001* (ACT) provides:

Prohibited conduct in dealings

(1) A party to a lease, or a party to negotiations for a proposed lease, must not, in dealings with another party to the lease or negotiations, engage in conduct that is unconscionable or harsh and oppressive.

In the Tasmanian case, the expression "harsh" is joined by the expression "unjust." Significantly, Tasmania is unique in dealing with retail tenancy issues with a code of conduct prescribed under the *Fair Trading Act 1990* (Tas).[11] Clause 3(1) of the *Tasmanian Code of Practice for Retail Tenancies* provides that:

A person must not engage in conduct that is harsh, unjust or unconscionable.

In short, while Queensland,[12] Victoria[13] and the Northern Territory[14] have joined New South Wales and s 51AC in prohibiting conduct that is, in all the circumstances, unconscionable, the

[10] However, an important proviso to the operation of s 51AC of the *Trade Practices Act 1974* (Cth) relates to the supply or acquisition of goods or services needing to be one of less than $3 million: see s 51AC(9) and (10).

[11] See *Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998* (Tas).

[12] See *Retail Shop Leases Act 1994* (Qld), s 46A(1) and (2).

[13] See *Retail Leases Act 2003* (Vic), ss 77(1), 78(1).

Australian Capital Territory and Tasmania have used additional concepts such as "harsh," "oppressive", or "unjust" in drafting their provisions.

Importantly, the Australian Capital Territory and Tasmania have also gone further in identifying specific forms of conduct caught by their prohibitions. For example, s 22(3) of the *Leases (Commercial and Retail) Act 2001* (ACT) states that:

> (3) Without limiting subsection (1), a lessor is taken to have engaged in harsh and oppressive conduct if:
>
> (a) the lessor discriminates against a tenant because the tenant is a member of, or intends to become a member of, an association to represent or protect the interests of tenants, or intends to form such an association; or
>
> (b) the lessor's conduct has the effect of preventing a tenant from forming or joining, or compelling a tenant to form or join, an association to represent or protect the interests of tenants.

Similarly, cl 3(2) of the Tasmanian code of conduct states:

> (2) Without limiting the generality of subclause (1), unconscionable conduct may include the threat by a property owner:
>
> (a) to subsidise a competitor to the tenant in nearby premises; or
>
> (b) not to renew a lease unless the tenant:
>
> (i) agrees to a proposal of the property owner; or
>
> (ii) is prepared to pay a rental in excess of the market value rent.

While not going to the extent of the Australian Capital Territory or Tasmania in identifying specific forms of conduct covered by the prohibition, Victoria has included new matters that its Tribunal can take into account in determining if there has been a breach of its prohibition:

> (l) the extent to which the landlord was not reasonably willing to negotiate the rent under the lease; and
>
> (m) the extent to which the landlord unreasonably used information about the turnover of the tenant's or a previous tenant's business to negotiate the rent; and
>
> (n) the extent to which the landlord required the tenant to incur unreasonable fit out costs.[15]

The addition of these new matters in the Victorian legislation needs to be balanced to some degree against Victoria's insertion of a further example of conduct not to be taken as unconscionable under the legislation. Thus, while the Victorian legislation, like the New South Wales and Queensland legislation,[16] provides that the bringing of legal proceedings, the referral of the matter to arbitration, or a failure to renew a lease is not to be taken as unconscionable under the legislation, Victoria adds a new example:

> 79 Certain conduct is not unconscionable
>
> A person is not to be taken for the purposes of section 77 or 78 to engage in unconscionable conduct in connection with a retail premises lease merely because:
>
> …
>
> (c) the person does not agree to having an independent valuation of current market rent carried out.

Interestingly, apart from the addition of a new type of conduct, there is slight variation in the equivalent provisions to s 79 of the Victorian legislation. For example, Victoria goes further on the referral of a dispute to arbitration and includes conciliation, mediation or some other form of alternative dispute resolution, while the Australian Capital Territory provision does not include reference to either a referral of a dispute to arbitration, or to a failure to renew or issue a new lease[17] and the Northern Territory provision does not include a referral of a dispute to arbitration.[18]

---

[14] See *Business Tenancies (Fair Dealings) Act 2003* (NT), ss 79(1), 80(1).

[15] See *Retail Leases Act 2003* (Vic), s 77(2). Under s 78(2) of the *Retail Leases Act 2003* (Vic), a comparable set of these additional matters may also be taken into account in considering the conduct of tenants.

[16] See s 62B(5)(6) of the *Retail Leases Act 1994* (NSW); s 46A(3) of the *Retail Shop Leases Act 1994* (Qld).

[17] See *Leases (Commercial and Retail) Act 2001* (ACT), s 22(4).

[18] See *Business Tenancies (Fair Dealings) Act 2003* (NT), s 81.

Overall, it is evident that, while there are similarities in both policy and substance between the various State and Territory provisions and s 51AC, there are clear differences between them. With such differences, it is hardly surprising that there has been ongoing debate regarding not only how far these statutory provisions go in promoting a new standard of ethical conduct within retail tenancies, but how best to promote uniformity in this standard across jurisdictions. In turn, this debate raises issues such the need for a definition of the expression "unconscionable conduct," the ways uniformity can best be attained and whether or not these statutory provisions adequately deal with allegedly unfair clauses in retail leases.

STATE AND TERRITORY PROVISIONS DEALING WITH UNCONSCIONABLE CONDUCT: A QUESTION OF DEFINITION

A review of the background to the enactment of s 51AC of the Act reveals that there was some debate regarding the use of the expression "unconscionable conduct". Indeed, in a report handed down by the House of Representatives Standing Committee on Industry, Science and Technology, *Finding a Balance: Towards Fair Trading in Australia*,[19] the Committee recommended that a new provision be inserted in the Act to prohibit "conduct that is, in all the circumstances, unfair". In doing so, the report expressed some reservations in using the expression "unconscionable conduct" in any new statutory standard. For example, the report noted that employing the word "unconscionable" in the statutory standard would retain in the Act the legal history associated with that word and this would lead to a tension between that history and the legislative intention to broaden the equitable doctrine of unconscionability.[20] Clearly, the report saw the enactment of a broader prohibition against unfair business conduct as a key element in promoting better business conduct in the retail tenancy area and, accordingly, took the view that a new concept was needed.[21]

In responding to the Committee's recommendation, however, the federal government decided against the use of the word "unfair", instead preferring the expression "unconscionable conduct" in drafting s 51AC.[22] While no doubt intending that the statutory concept of unconscionable conduct would have a wider operation than the equitable doctrine, the use of the expression unconscionable conduct in the proposed s 51AC clearly carried the risk that the courts would take a cautious approach to the statutory concept, particularly given their well-established views on the very limited scope of the equitable doctrine of unconscionability. Significantly, the risk of such a cautious approach being taken was increased by the omission of a definition of the expression "unconscionable conduct" as used in s 51AC. While the inclusion of a non-exhaustive list of factors that the courts could have regard to in dealing with claims under s 51AC was intended to provide some guidance to the courts, the failure to include a definition of unconscionable conduct meant that the scope of the new statutory concept was essentially left to the courts to decide. In turn, this carried the risk of an ongoing debate as to how far the statutory concept extended in promoting ethical conduct in business transactions.

Needless to say, such possible risks extend to any State and Territory provisions modeled on s 51AC. Indeed, with the States and Territories having decided to draw down s 51AC into their retail tenancy legislation, the risk of a cautious judicial approach, as well as a possible debate as to the intended reach of s 51AC, would extend to these State or Territory equivalents. In such circumstances, there would be merit in developing a clear definition of the concept of unconscionable conduct as used in s 51AC. This would promote a consistent understanding of the scope and nature of commercial unconscionability across Australia at a time when more jurisdictions are proposing to draw down s 51AC.[23] In short, while drawing down the provisions of s 51AC within retail tenancy legislation enables landlords and tenants to access the dispute resolution mechanisms within that jurisdiction's

[19] Standing Committee on Industry, Science and Technology, *Finding a Balance: Towards Fair Trading in Australia*, Report (1997) p 181, http://www.aph.gov.au/house/committee/isr/Fairtrad/report/CHAP6.PDF.

[20] Standing Committee on Industry, Science and Technology, n 19, p 178.

[21] Standing Committee on Industry, Science and Technology, n 19, p 179.

[22] See generally Department of Industry, Tourism and Resources, *New Deal: Fair Deal*, n 2.

[23] See, eg *Retail Shops and Fair Trading Legislation Amendment Bill 2005* (WA).

retail tenancy legislation, it is readily apparent that, if s 51AC was drawn down in all jurisdictions having retail tenancy legislation, the proliferation of such unconscionability provisions would carry the real risk of varying notions of commercial unconscionability emerging across jurisdictions. In view of this danger, it becomes critical for there to be clear understanding of types of conduct covered by s 51AC, and this would be greatly assisted by a plain English definition of what is meant by the expression "unconscionable conduct."

In this regard, the possibility of inserting such a plain English definition in relation to the proposed Western Australian equivalent of s 51AC has recently been raised by the Hon Anthony Fels during the Second Reading Speech of the *Retail Shops and Fair Trading Legislation Amendment Bill 2005* (WA). In doing so, the following definition has been proposed:

> "unconscionable conduct" includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.[24]

The proposed definition is intended to be non-exhaustive and its plain English drafting is clearly aimed at promoting a better understanding of the intended broad operation of provisions like s 51AC and its State and Territory equivalents. Importantly, the expression draws on concepts that have been recommended or are already in use in other legislation dealing with unethical conduct within a commercial context. For example, as discussed above, the word "unfair" was originally proposed as the central concept in what was to become s 51AC.[25] The word "unfair" has also been used to describe the types of contracts that the Industrial Relations Commission of New South Wales has had power to vary or set aside under s 106 of the *Industrial Relations Act 1996* (NSW). Similarly, such words as "harsh" and "oppressive" are, as noted above, already used in s 22 of the *Leases (Commercial and Retail) Act 2001* (ACT). By relying on concepts already in use or which are capable of being readily understood by those covered by s 51AC or its State and Territory equivalents, the proposed definition would not only assist in promoting consistency in the way that the statutory concept of "unconscionable conduct" is interpreted by courts and tribunals across Australia, but it would also be in keeping with the intended broad scope of the statutory concept. Such consistency is particularly valuable in an environment where there has been a proliferation of statutory provisions against unconscionable conduct.

STATE AND TERRITORY PROVISIONS DEALING WITH UNCONSCIONABLE CONDUCT: THE NEED FOR UNIFORMITY

On the issue of proliferation of unconscionability provisions within retail tenancy legislation, it is clear that this is a reflection of the multitude of retail tenancy legislation that exists around Australia. With the different State and Territory jurisdictions having enacted their own retail tenancy legislation, there has always been the risk of inconsistency across jurisdictions. Such inconsistencies raise compliance costs for the industry, particularly landlords and retailers operating nationally, and prompt debate as to the whether or not uniform retail tenancy legislation or a code should be enacted.

Importantly, in its report *Finding a Balance: Towards Fair Trading in Australia*, the House of Representatives Standing Committee on Industry, Science and Technology recommended a uniform retail tenancy code as another key element in promoting better business conduct in the retail tenancy area.[26] Indeed, the Committee noted that, since many of the major stakeholders in the retail tenancy area – property owners, property managers, retail chains, and franchise chains – operate on a national basis, they would benefit from consistency in legislative provisions.[27] Given the clear advantages associated with uniformity, it may be appropriate to explore the possibility of a developing a Model Law or Code that individual jurisdictions could adopt or apply.

[24] See Parliament of Western Australia, Legislative Council, *Debates* (9 May 2006) p 2291.

[25] Standing Committee on Industry, Science and Technology, n 19, p 181.

[26] Standing Committee on Industry, Science and Technology, n 19, p 25.

[27] Standing Committee on Industry, Science and Technology, n 19, p 24.

CREATING A NEW ETHICAL NORM OF CONDUCT: PROHIBITING UNCONSCIONABLE CONDUCT WITHIN TRADE OR COMMERCE GENERALLY

From the above discussion, it is evident that a significant limitation on the application of the State- and Territory-based provisions dealing with unconscionable conduct within retail tenancies exists, ie that the alleged conduct must be in connection with a retail lease. In seeking to use these provisions, there must be a sufficient link between the alleged conduct and a retail lease. Similarly, in seeking to use s 51AC, the conduct must not only be in trade or commerce, but there must also be a sufficient link between the conduct and the supply or acquisition, possible supply or acquisition of goods or services. Unlike s 52 which establishes a norm of conduct within trade or commerce generally, s 51AC and State- and Territory-based provisions have been expressly linked to the supply or acquisition of goods or services and retail leases respectively. Given the intended wider operation of provisions like s 51AC and equivalent State- and Territory-based provisions, there may be considerable merit in enacting prohibitions against unconscionable conduct within trade or commerce generally in both the *Trade Practices Act* and State and Territory *Fair Trading Acts*.

In short, it may be time to consider whether or not there should be a prohibition in both the *Trade Practices Act* and the State and Territory *Fair Trading Acts* against unconscionable commercial conduct within trade or commerce generally, rather than provisions like the current s 51AC which require a link with the supply or acquisition of goods or services, or State- and Territory-based provisions that require a link with retail tenancies. Significantly, a prohibition against unconscionable commercial conduct in trade or commerce generally would bring such provisions as s 51AC into line with s 52 and ensure their development as a general ethical norm of conduct within commercial dealings. In turn, that would lead to a rationalisation of the three unconscionability provisions currently found in the *Trade Practices Act*, bring State and Territory *Fair Trading Acts* into line with the *Trade Practices Act* in the area of unconscionable conduct, and remove the need for industry-specific prohibitions against unconscionable commercial conduct.

NEW DIRECTIONS IN DEALING WITH ALLEGEDLY UNFAIR TERMS IN RETAIL LEASES

Finally, the issue arises as to whether or not s 51AC and its State and Territory equivalents allow the courts and retail tenancy tribunals to consider claims based solely on the alleged unfairness of a term of a retail lease. In this regard, it is important to note the comments of the Full Federal Court in *Hurley v McDonald's Australia Ltd* [2000] ATPR 41-741 at 40,585-40,586; [1999] FCA 1728 that something more is required than merely pointing to the terms of the contract:

> 24 No allegation of unconscionable conduct is made in … relation to the making of the alleged contracts between McDonalds, on the one hand, and the Applicant and the group members, on the other. The allegation is simply that it would be unconscionable for McDonalds to rely on the terms of such contracts.
>
> …
>
> 29 There is no allegation of any circumstance that renders reliance upon the terms of the contracts unconscionable. For example, it might be that, having regard to particular circumstances it would be unconscionable for one party to insist upon the strict enforcement of the terms of a contract. One such circumstance might be that an obligation under a contract arises as a result of a mistake by one party. The mistake is an additional circumstance that might render strict reliance upon the terms of the contract unconscionable. Mere reliance on the terms of a contract cannot, without something more, constitute unconscionable conduct.
>
> …
>
> 31 Before sections 51AA, 51AB or 51AC will be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract "unfair" or "unreasonable" or "immoral" or "wrong".

From such comments it would appear that the courts have taken the view that the terms of a contract cannot, on their own, form the basis of an action under s 51AC.

With this in mind, it may be time to adopt a new regulatory framework that specifically targets allegedly unfair *terms* in retail leases. Such a framework would allow the courts or retail tenancy tribunals to consider claims based solely on the alleged unfairness of a term in a retail lease. Such a

new regulatory framework could be based on the existing United Kingdom and Victorian models dealing with unfair terms in consumer contracts.[28] Importantly, the new regulatory framework would provide a more targeted and effective mechanism for dealing directly with unfair terms in retail leases than is currently provided by either the equitable doctrine of unconscionability or s 51AC and its State and Territory equivalents.

CONCLUDING REMARKS

While the enactment of s 51AC and its State and Territory retail tenancy equivalents has introduced a broader notion of unconscionable conduct than the judicially developed equitable doctrine of unconscionability, the full reach of the statutory notion remains unclear and, in this regard, it may be useful for a statutory definition to be inserted. Clearly, such a definition would not be an exhaustive one, but rather could be drafted in a plain English manner as a way of putting beyond doubt that the statutory notion is a broad one and that it is in no way restricted by any judicial preconceptions flowing from the equitable doctrine. The insertion of such a definition could be an important element in educating those involved in the retail tenancy area about the new standard of ethical conduct that s 51AC and its State and Territory equivalents are seeking to promote. The inclusion of a statutory definition of the expression unconscionable conduct could be part of an overall strategy in which a uniform retail tenancy code or legislative scheme is implemented and supplemented by a new regulatory framework for dealing solely with allegedly unfair terms in retail leases.

Frank Zumbo
Associate Professor, University of New South Wales, School of Business Law and Taxation

[28] See *Unfair Terms in Consumer Contracts Regulations 1999* (UK); *Fair Trading Act 1999* (Vic), Pt 2B. For a discussion on the operation of these models see Zumbo, n 1; Zumbo F, "Dealing with Unfair Terms in Consumer Contracts: The search for a new regulatory model" (2005) 13 TPLJ 194.

Promoting fairer franchise agreements: A way forward?

*Frank Zumbo**

The question of whether or not the judiciary or the legislature should intervene to promote fairer franchise agreements is a longstanding and difficult one. At the heart of the question is the need to balance a franchisor's ability to maintain the integrity of the franchise system by being able to enforce franchisee conformity with that system, and ensuring that a franchisee's contractually captive status is not exploited by the franchisor through the inclusion of contractual terms in the franchise agreement that are not reasonably necessary for the protection of the franchisor's legitimate interests. Within this context the article will consider whether or not existing Australian laws allow sufficient scope to deal with allegations that a franchisor has included contractual terms in a franchise agreement that are not reasonably necessary to protect the legitimate interests of the franchisor. Where existing laws are found to be lacking, the article will explore possible new legislative frameworks that could be implemented to allow judicial consideration of allegedly unfair contractual terms.

Introduction

The question of whether the judiciary or the legislature should intervene to promote fairer franchise agreements is a longstanding and difficult one. At the heart of the question is the need to balance a franchisor's ability to maintain the integrity of the franchise system by being able to enforce franchisee conformity with that system, and ensuring that a franchisee's contractually captive status is not exploited by the franchisor through the inclusion of contractual terms in the franchise agreement that are not reasonably necessary for the protection of the franchisor's legitimate interests. In Australia the question of fairness within franchising arrangements has historically been restricted to judicial and statutory concepts of unconscionability. These existing notions of unconscionability have, in turn, focused on what has traditionally been referred to as procedural unconscionability. In particular, the focus has been on the franchisor's conduct towards the franchisee in the making of the contract or during the course of their relationship rather than solely on the fairness or otherwise of the actual terms of the franchise agreement. Not surprisingly, this judicial and statutory focus on procedural unconscionability has meant that little, if any, attention has been focused on what is described as substantive unconscionability.

Indeed, with substantive unconscionability concerned with the fairness or otherwise of the terms of the contract, the refusal by Australian courts to consider claims based solely on the alleged unfairness of the terms of a contract has meant that such claims have rarely been tested before the courts. While there may be instances where claims of substantive unconscionability may come before the courts, these will tend to occur where claims of

* Associate Professor, School of Business Law and Taxation, University of New South Wales.

procedural unconscionability are also being made by the weaker contractual party. In short, the procedural unconscionability bias of existing judicial or statutory concepts of unconscionability has meant that the question of whether or not the terms of a franchise agreement need to be fair and reasonable has historically received little judicial attention. In the absence of judicial scrutiny, there has been growing interest amongst law reform and other policy development bodies, both in Australia and the United Kingdom, as to whether or not there should be a new legislative framework that focuses solely on the fairness or otherwise of the terms of commercial contracts.

Such interest by law reform and other policy development bodies has centred on the question of whether or not a new legislative framework is needed to deal with contractual terms that are unfair on the basis that they are not reasonably necessary to protect the legitimate interests of the party seeking to rely on the term. This, in turn, raises three broad questions. Firstly, should the courts or the legislature be concerned with the fairness or otherwise of contractual terms within a commercial context and, in particular, the terms of a franchise agreement? This clearly focuses attention on whether franchisees are sufficiently able to look after their own interests or whether their contractually captive status makes them vulnerable to franchisors intent on imposing contractual terms that are not reasonably necessary for the protection of the franchisor's legitimate interests. In short, this first question involves balancing the respective interests of franchisors and franchisees in what is typically a longstanding and mutually dependent relationship.

In considering the respective interests of the franchisors and franchisees it is readily apparent that while franchisors need to be able to maintain and enforce the integrity of the franchise system, it would be of concern if franchisors used this position to include terms in the franchise agreement that went beyond what was reasonably necessary for the protection of the franchisor's legitimate interests. In view of these concerns, a second question arises as to whether or not existing laws adequately deal with terms of a franchise agreement that allegedly go beyond what was reasonably necessary for the protection of the franchisor's legitimate interests.

Finally, where existing laws arguably fail to adequately deal with a particular concern, the question arises as to whether or not a new legislative framework is required to deal with that particular concern.

Should the courts or the legislature be concerned with the fairness or otherwise of the terms of a franchise agreement?

While the courts and the legislature have allowed allegations of unconscionable conduct on the part of the stronger contractual party to be reviewed, this willingness has hitherto not been extended to allowing the fairness or otherwise of the terms of the contract to be reviewed. Historically, this has been because of the adherence to the longstanding notion of freedom of contract. Under this notion, the parties were presumed to have freely negotiated the terms of the contract and to have freely entered the contract. Having done so, courts took the view that the contracting parties were to be bound by the contract and that the courts would not intervene on the grounds

of unconscionable conduct unless the conduct of the stronger party during the making of the contract fell within well established parameters. These parameters were very narrowly defined by the courts and came to be known as the equitable doctrine of unconscionability.

In the late 1970s and 1980s there was a growing acceptance on the part of Australian legislatures that the equitable doctrine of unconscionable conduct was unduly narrow and did not allow for consideration of a broader range of circumstances under which the weaker contractual party could be on the receiving end of exploitative, harsh or oppressive conduct by the stronger party. As a result, Australian legislatures enacted broader statutory notions of unconscionable conduct. These broader statutory notions of unconscionable conduct have been in operation in Australian for over 25 years in relation to consumers and almost 10 years in relation to small business. Importantly, these broader statutory notions have focused attention on how the stronger party behaves towards the weaker party not only in the making of the contract but also during the course of their dealings. Clearly, the legislature recognised that the growing disparity in the bargaining power of the parties in some contractual relationships could lead to conduct that was unconscionable under a broader meaning of the term than had been previously used by the courts. Indeed, consumers and small businesses were viewed as being potentially vulnerable to exploitative, harsh or oppressive conduct by large businesses during the course of their dealings. While initially it was only consumers that were seen as being vulnerable because of their lack of bargaining power in the negotiation process or their contractually captive position in longer term contracts, in more recent times such concerns have emerged in relation to small businesses dealings with larger businesses within a number of ongoing relationships such as supply agreements, retail tenancies and franchising.

Although succeeding in widening the meaning of the expression 'unconscionable conduct', the statutory notions of unconscionability have been given a clear procedural unconscionability bias by the courts. In doing so, the courts have focused almost exclusively on whether or not there has been exploitative, harsh or oppressive conduct by the stronger parties rather than allowing a broader review of the stronger party's inclusion of contractual terms that are not reasonably necessary to protect the legitimate interests of the party. Once again, the courts adherence to the notion of freedom of contract meant that they were refraining from using the statutory notions of unconscionability to deal with allegations based solely on the alleged unfairness of contractual terms. During the 1990s, however, legislatures started to again question whether or not the notion of freedom of contract properly reflected modern circumstances, especially given that in a consumer context contracts were increasingly likely to be 'standard form' leaving little, if any, room for the consumer to renegotiate the 'standard terms'. In short, the obvious disparity of bargaining power between consumers and large businesses meant that contracts were (i) increasingly standard across whole industries, (ii) were offered on a 'take it or leave it' basis, and (iii) included terms that went beyond what was reasonably necessary to protect the legitimate interests of the business.

The growing use of standard form contracts and the inability of consumers to renegotiate the terms of such contracts were seen as particular concerns

within consumer transactions. This concern led to the United Kingdom[1] and more recently the Australian State of Victoria[2] to enact legislation dealing directly with allegedly unfair terms in consumer contracts. With the sole focus of this legislation being to make void or unenforceable unfair terms in consumer contracts, it is clear that the legislation is aimed at providing a mechanism for dealing with contractual terms that go beyond what is reasonably necessary to protect the legitimate interests of the stronger party. By dealing with allegedly unfair contractual terms, this legislation is concerned to ensure that the inequality of bargaining power increasingly faced by consumers in their dealings with large businesses is not taken advantage of by the business to include terms not reasonably necessary for the legitimate protection of its interests.

This growing recognition among legislatures that a significant imbalance of bargaining power between consumers and large business may be exploited by the business in the drafting of contracts has prompted debate as to whether a growing imbalance of bargaining power between small businesses and larger businesses may also lead to the larger businesses drafting contracts to include terms not reasonably necessary to protect its legitimate interests. This debate has emerged from discussion papers prepared by law reform bodies in Australia and the United Kingdom. In January 2004 the Australian Standing Committee of Officials of Consumer Affairs (SCOCA) released a national discussion paper on the issue of unfair contract terms in which it called for comment on the possible inclusion of business to business contracts in any legislation dealing with unfair contract terms.[3] Similarly, in 2002 the English Law Commission issued a consultation paper on unfair terms in contracts in which it considered extending the protection against unfair terms to businesses.[4]

Both papers include a number of arguments both for and against including business to business contracts within a legislative framework for dealing with unfair contract terms. In doing so, it is readily apparent that both papers have identified allegedly unfair terms in business to business contracts involving small business as an issue needing to be addressed. Indeed, while both papers acknowledged the commercial character of business to business contracts and the possibly greater sophistication of small businesses as compared to consumers,[5] both papers expressed concern that small businesses in many cases faced comparable imbalances in bargaining power when dealing with

1 The UK legislation was implemented first and is now found in the Unfair Terms in Consumer Contracts Regulations 1999. These Regulations came into force on 1 October 1999.

2 The Victorian legislation is found in Pt 2B of the Fair Trading Act 1999 and came into force on 9 October 2003.

3 <http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/CD456F7C38F523684A256E240014EF7C?OpenDocument&L1=Publications>.

4 <http://www.lawcom.gov.uk/docs/cp166.pdf>.

5 See The Law Commission, *Unfair terms in contracts: A joint consultation paper*, Consultation Paper No 166, London, England, 2002, p 131. See also The Standing Committee of Officials of Consumer Affairs (SCOCA), *Unfair contract terms: A discussion paper*, 2004, p 54.

larger businesses as the imbalances faced by consumers when dealing with large businesses.[6]

Similarly, both papers also formed the view that the use of standard form contracts offered on a take it or leave it basis within a business to business context could, as in the case of consumer contracts, possibly lead to the inclusion of potentially unfair terms in contracts between small businesses and larger businesses.[7] Within this context, both papers identified examples of what could potentially be seen as unfair terms in a business to business context. For example, the English Law Commission identified the following contractual terms as potentially going beyond what was reasonably necessary to protect the legitimate interests of the stronger party:

- deposits and forfeiture of money paid clauses;
- high default rates of interest (unless these can be shown to be penalties);
- clauses allowing unilateral variation in price;
- termination clauses allowing one party to terminate in a wider set of circumstances than allowed for the other party;
- unequal notice periods; and
- arbitration and jurisdictional clauses which seek to severely restrict the rights of a party to choose the forum for dispute resolution.[8]

In short, while both papers recognised that the potential problems with allegedly unfair terms could, when compared to consumer contracts, be less severe in business to business contracts involving small business, such problems could arise and therefore needed to be considered.[9]

In doing so, it must be remembered that consideration of allegedly unfair terms in business to business contracts such as franchise agreements is only concerned with the question of whether or not the franchisor has included terms that are not reasonable necessary for the protection of the franchisor's legitimate interests. Clearly, a franchisor is perfectly entitled to rely on contractual terms that are reasonably necessary to protect its legitimate interests. Indeed, both contracting parties should be entitled to include contractual terms that are reasonably necessary to protect their respective legitimate interests. In this sense, freely negotiated contracts may be seen as involving a sharing or an apportioning of the contractual risks and rewards between the parties. In particular, in any genuine negotiation process the parties will seek to strike a balance in their respective rights and obligations arising from the contract. Where, however, the franchise agreement includes terms that are not reasonably necessary to protect the franchisor's legitimate interests, there is a real danger that the franchise agreement has been drafted in a way that: seeks to shift those contractual risks disproportionately onto the franchisee; creates an significant imbalance in the respective rights and obligations of the parties in favour of the franchisor; or simply seeks to impose an additional detriment on the franchisee or minimises the potential benefit to the franchisee under the contract without any offsetting reward.

---

6 The Law Commission, above n 5, p 131. See also SCOCA, above n 5, p 50.
7 See The Law Commission, above n 5, p 130. See also SCOCA, above n 5, p 50.
8 See The Law Commission, above n 5, p 126. See also SCOCA, above n 5, p 51.
9 See The Law Commission, above n 5, p 131. See SCOCA, above n 5, p 50.

Thus, the issue of fairness when dealing with unfair terms in business to business contracts such as franchise agreements involves an objective assessment of particular contractual terms. Fairness within this context is to be tested by an objective standard of whether or not a contractual term that places a franchisee at a disadvantage is reasonably necessary for the protection of the legitimate interests of the franchisor. Implicit in such a standard is the recognition that a franchise agreement involves trade offs whereby a franchisee may be disadvantaged in one way, but is rewarded in another way so as to offset the disadvantage. Where the offsetting reward is reasonably proportionate to the disadvantage, the franchisor would be entitled to contractually protect the trade off. As the reward is reasonably proportionate to the disadvantage and the franchisor may itself be at a financial disadvantage if the trade off is not contractually protected, the franchisor would be entitled to claim the relevant contractual terms protecting the trade off as reasonably necessary for the protection of the legitimate interests of the franchisor. In this way seeking to deal with unfair terms in franchise agreements would in no way detract from, or undermine the franchisor's ability to include contractual terms that are reasonably necessary to protect its legitimate interests.

Do existing laws allow the courts to deal directly with terms of a franchise agreement that allegedly go beyond what was reasonably necessary for the protection of the franchisor's legitimate interests?

While there may be instances where a franchisor may choose to include terms in a franchise agreement that are arguably not reasonably necessary for the protection of the franchisor's legitimate interests, Australian courts have, as discussed above, traditionally refused to consider such claims in their own right. In particular, judicial and statutory concepts of unconscionability have historically had a procedural unconscionability bias with the courts having a clear preference for focusing almost exclusively on the stronger party's conduct in the making of the contract or during the course of the relationship. In the absence of such conduct being considered 'unconscionable', the courts have generally refrained from considering the fairness or otherwise of contractual terms. Not only have the courts historically taken a narrow view of what they would consider 'unconscionable' at equity, but they have also been reluctant to use more recently enacted statutory notions of unconscionability to consider the fairness or otherwise of the terms of contract.

This judicial reluctance to rely on statutory notions of unconscionability to deal with issues of substantive unconscionability can be seen from a review of the Australian cases dealing with equitable and statutory concepts of unconscionable conduct. Interestingly, these statutory concepts of unconscionability were intended to have a broader operation than the equitable doctrine of unconscionability, a doctrine that could only be invoked where the weaker party was under a particular type of 'special disadvantage' recognised by the courts. While the categories of special disadvantage were not closed, the courts did focus on particular types of categories of 'special disadvantage'. This can be seen from the following comments by Mason J in

Commercial Bank of Australia Ltd v Amadio, the landmark Australian case on the equitable doctrine of unconscionability:

> It goes almost without saying that it is impossible to describe definitively all the situations in which relief will be granted on the ground of unconscionable conduct. As Fullagar J said in *Blomley v Ryan* (1956) 99 CLR 362, at 405: 'The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-à-vis the other.'
>
> Likewise Kitto J (at 415) spoke of it as 'a well-known head of equity' which '. . . applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands'.
>
> It is not to be thought that relief will be granted only in the particular situations mentioned by their Honours. It is made plain enough, especially by Fullagar J, that the situations mentioned are no more than particular exemplifications of an underlying general principle which may be invoked whenever one party by reason of some condition or circumstance is placed at a special disadvantage vis-à-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created. I qualify the word 'disadvantage' by the adjective 'special' in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasise that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party.[10]

In outlining what his Honour considered to be the underlying principle in relation to the equitable doctrine of unconscionability, Mason J had emphasised the need to show a special disadvantage along with an unconscientious taking advantage of that 'disabling condition' as being essential ingredients in the equitable doctrine. This principle remains the same today and reinforces the need to demonstrate the existence of procedural unconscionability before the court will even consider the terms of the contract itself.

This continued emphasis on procedural unconscionability means that little, if anything, of substance has changed with the equitable doctrine of unconscionability since the *Amadio* case. Not only have the courts consistently restricted themselves to consideration of the long established categories of special disadvantage as the basis for granting relief under the equitable doctrine, but the High Court has emphatically refused to consider inequality of bargaining power, even a major disparity of bargaining power, as sufficiently 'special' to constitute a disabling condition permitting the equitable doctrine's intervention. This has been especially true in cases involving commercial transactions. Indeed, in its recent decision in *ACCC v*

10 (1983) 151 CLR 447; 46 ALR 402 at 412–13.

C G Berbatis Holdings Pty Ltd,[11] a commercial tenancy case, the High Court has made it clear that an inequality of bargaining power on its own will not give rise to a special disadvantage. Provided a person is capable of understanding the nature of the transaction, an inequality of bargaining or even a taking advantage of that inequality of bargaining power by the stronger party will not be sufficient to invoke the equitable doctrine. This position clearly emerges from the following comments by Gleeson CJ in that case:

> One thing is clear . . . A person is not in a position of relevant disadvantage . . . simply because of inequality of bargaining power.
>
> . . .
>
> Unconscientious exploitation of another's inability, or diminished ability, to conserve his or her own interests is not to be confused with taking advantage of a superior bargaining position. There may be cases where both elements are involved, but, in such cases, it is the first, not the second, element that is of legal consequence.[12]

Similar comments were made by Gummow and Hayne JJ:

> . . . It will be apparent that the special disadvantage of which Mason J spoke in [the *Amadio* case] was one seriously affecting the ability of the innocent party to make a judgment as to that party's own best interests.
>
> In the present case, the respondents emphasise that point and stress that a person in a greatly inferior bargaining position nevertheless may not lack capacity to make a judgment about that person's own best interests. The respondents submit that the facts in the present case show that Mr and Mrs Roberts [as tenants] were under no disabling condition which affected their ability to make a judgment as to their own best interests in agreeing to the stipulation imposed by the owners for the renewal of the lease, so as to facilitate the sale by Mr and Mrs Roberts of their business. Those submissions should be accepted.[13]

As the retail tenants understood the nature of the transaction that was before them, the High Court considered that they were able to make a decision about what was in their best interest notwithstanding the great disparity of bargaining power between the parties and that the stipulation offered by the landlord for the renewal of the lease was effectively done so on a take it or leave it basis. Clearly, under the equitable doctrine the focus of the inquiry is on whether or not one of the parties is affected by a disabling condition recognisable by the courts. Accordingly, the equitable doctrine has no role to play where, absent a recognisable disabling condition, a party to a contract understands or is capable (for example, through independent legal advice) of understanding the nature of the transaction. A gross inequality of bargaining power and having no real choice but to accept allegedly unfair contractual terms are not in themselves 'special' enough for the equitable doctrine. In summary, the High Court's emphasis on procedural unconscionability or the requirement that there be a disabling condition recognisable by the courts means that in the absence of such a disabling condition the equitable doctrine has no role to play in dealing with unfair contractual terms.

Ironically, the limitations of the equitable doctrine of unconscionability

---

11 (2003) 214 CLR 51; 197 ALR 153.
12 Ibid, at [11]–[14].
13 Ibid, at [55]–[56].

were being expressed in the late seventies and early eighties[14] and were being responded to by Australian legislatures at that time; firstly, by the NSW Parliament[15] and then followed closely by the Federal Parliament.[16] Indeed, there can be little doubt that these legislative responses were intended to expand the notion of unconscionability to one more responsive to what were perceived as the 'modern' needs of the time. Even in the early eighties the equitable doctrine was viewed as a very narrow one based on notions of procedural unconscionability restricted essentially to whether or not a party to the contract was under a recognisable disabling condition in the lead up to the making of the contract. Faced with a narrow equitable notion of unconscionability and a judicial unwillingness to broaden the scope of that doctrine, it was generally considered that only statutory intervention would bring about a doctrine of unconscionability more responsive to the then 'modern' concerns arising from a growing inequality of bargaining power; standard form contracts and substantive unconscionability.

In seeking to deal with these concerns the Federal Parliament enacted such provisions as s 51AB and s 51AC of the Trade Practices Act 1974 (Cth) (TPA). Of these provisions, s 51AB came first and was aimed at consumer transactions:

> (1) A corporation shall not, in trade or commerce, in connection with the supply or possible supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.
>
> (2) Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person (in this subsection referred to as the *consumer*), the Court may have regard to:
>
> (a) the relative strengths of the bargaining positions of the corporation and the consumer;
>
> (b) whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation;
>
> (c) whether the consumer was able to understand any documents relating to the supply or possible supply of the goods or services;
>
> (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the consumer or a person acting on behalf of the consumer by the corporation or a person acting on behalf of the corporation in relation to the supply or possible supply of the goods or services; and
>
> (e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation.
>
> (3) A corporation shall not be taken for the purposes of this section to engage in unconscionable conduct in connection with the supply or possible supply of

14 See, generally, J Peden, *Harsh and Unconscionable Contracts*, Report to Minister for Consumer Affairs and Co-operative Societies and the Attorney-General for New South Wales, 1976.

15 See Contracts Review Act 1980 (NSW).

16 See s 51AB of the TPA.

goods or services to a person by reason only that the corporation institutes legal proceedings in relation to that supply or possible supply or refers a dispute or claim in relation to that supply or possible supply to arbitration.

(4) For the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person:

(a) the Court shall not have regard to any circumstances that were not reasonably forseeable at the time of the alleged contravention; and

(b) the Court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.

(5) A reference in this section to goods or services is a reference to goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption.

(6) A reference in this section to the supply or possible supply of goods does not include a reference to the supply or possible supply of goods for the purpose of re-supply or for the purpose of using them up or transforming them in trade or commerce. . . .

More recently, s 51AC of the TPA was enacted in relation to business to business contracts involving small business:

(1) A corporation must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a person (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);

(c) engage in conduct that is, in all the circumstances, unconscionable.

(2) A person must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a corporation (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a corporation (other than a listed public company);

engage in conduct that is, in all the circumstances, unconscionable.

(3) Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation or a person (the supplier)[17] has contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the business consumer), the Court may have regard to:

(a) the relative strengths of the bargaining positions of the supplier and the business consumer; and

(b) whether, as a result of conduct engaged in by the supplier, the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

whether the business consumer was able to understand any documents relating to the supply or possible supply of the goods or services; and

(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on

17 While s 51AC(3) deals with the conduct of suppliers, it should be noted that s 51AC(4) deals with the conduct of acquirers. For present purposes, s 51AC(4) and other subsections of s 51AC related to s 51AC(4) have been omitted.

behalf of the business consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and

(e) the amount for which, and the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier; and

(f) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; and

(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the business consumer acted on the reasonable belief that the supplier would comply with that code; and

(i) the extent to which the supplier unreasonably failed to disclose to the business consumer:

(I) any intended conduct of the supplier that might affect the interests of the business consumer; and

(II) any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); and

(j) the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; and

(k) the extent to which the supplier and the business consumer acted in good faith.

...

(5) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with:

(a) the supply or possible supply of goods or services to another person; or

(b) the acquisition or possible acquisition of goods or services from another person;

by reason only that the first-mentioned person institutes legal proceedings in relation to that supply, possible supply, acquisition or possible acquisition or refers to arbitration a dispute or claim in relation to that supply, possible supply, acquisition or possible acquisition.

(6) For the purpose of determining whether a corporation has contravened subsection (1) or whether a person has contravened subsection (2):

(a) the Court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and

(b) the Court may have regard to circumstances existing before the commencement of this section but not to conduct engaged in before that commencement.

(7) A reference in this section to the supply or possible supply of goods or services is a reference to the supply or possible supply of goods or services to a person whose acquisition or possible acquisition of the goods or services is or would be for the purpose of trade or commerce.

...

(9) A reference in this section to the supply or possible supply of goods or services does not include a reference to the supply or possible supply of goods or services at a price in excess of $3,000,000, or such higher amount as is prescribed.

A number of points can immediately be made regarding s 51AB and s 51AC. Firstly, they refer to conduct that is in all the circumstances 'unconscionable' and list a number of non-exhaustive matters that the courts may take into account when considering whether or not the conduct is 'unconscionable' under the provision. Secondly, the matters listed in both sections raise both procedural and substantive unconscionability issues. Thirdly, and more importantly, as the matters in both sections are neither exhaustive nor restricted to procedural unconscionability there was some hope that the courts could seek to develop a broader notion of unconscionability that could also deal with allegations based solely on the substantive unfairness of the terms of the contract. In practice, however, there has been a natural inclination by the courts to emphasise procedural unconscionability in cases under s 51AB and s 51AC.

Indeed, the courts have noted that the terms of a contract cannot, on their own, form the basis of an action under s 51AB and s 51AC. In the words of the Full Federal Court in *Hurley v McDonald's Australia Ltd* something more is required than merely pointing to the terms of the contract:

> No allegation of unconscionable conduct is made in . . . relation to the making of the alleged contracts between McDonalds, on the one hand, and the Applicant and the group members, on the other. The allegation is simply that it would be unconscionable for McDonalds to rely on the terms of such contracts.
>
> . . .
>
> There is no allegation of any circumstance that renders reliance upon the terms of the contracts unconscionable. For example, it might be that, having regard to particular circumstances it would be unconscionable for one party to insist upon the strict enforcement of the terms of a contract. One such circumstance might be that an obligation under a contract arises as a result of a mistake by one party. The mistake is an additional circumstance that might render strict reliance upon the terms of the contract unconscionable. Mere reliance on the terms of a contract cannot, without something more, constitute unconscionable conduct.
>
> . . .
>
> Before sections 51AA, 51AB or 51AC will be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract '*unfair*' or '*unreasonable*' or '*immoral*' or '*wrong*'.[18]

These comments have more recently been echoed by Nicholson J in *ACCC v Lux Pty Ltd*:

> To ground a finding of contravention of s 51AB, there must be some circumstance other than the mere terms of the contract itself which renders reliance on the terms of the contract unconscionable . . .[19]

In short, s 51AB and s 51AC cannot be used by a party to prevent the enforcement of a contractual term unless there is some additional circumstance arising from the particular case that would render the enforcement of that term unconscionable. Thus, for the purposes of s 51AB and s 51AC a party to a contract is, in the absence of procedural unconscionability on their part, able to rely on the terms of a contract. Clearly,

18 (2000) ATPR 41-741 at [24]–[31].
19 [2004] FCA 926 (unreported, 16 July 2004, BC200404429) at [94].

substantive unconscionability or the alleged unfairness of a contractual term will not, on its own, be enough to bring an action under s 51AB and s 51AC. Once again, the courts have focused on the conduct of the parties in the making of the contract or during the course of the contractual relationship rather than dealing solely with allegations that the stronger party has included terms that are not reasonably necessary to protect its legitimate interests.

This judicial focus on the conduct of the parties in the making of the contract or during the course of the contractual relationship is also found in the approach taken under s 106 of the Industrial Relations Act 1996 (NSW), a NSW statute that gives the Industrial Commission of New South Wales in Court Session (the Commission) the power to deal with an 'unfair contract' in very specific circumstances:

> (1) The Commission may make an order declaring wholly or partly void, or varying, any contract whereby a person performs work in any industry if the Commission finds that the contract is an unfair contract.
>
> (2) The Commission may find that it was an unfair contract at the time it was entered into or that it subsequently became an unfair contract because of any conduct of the parties, any variation of the contract or any other reason.
>
> (2A) A contract that is a related condition or collateral arrangement may be declared void or varied even though it does not relate to the performance by a person of work in an industry, so long as:
>
> (a) the contract to which it is related or collateral is a contract whereby the person performs work in an industry, and
>
> (b) the performance of work is a significant purpose of the contractual arrangements made by the person.
>
> (3) A contract may be declared wholly or partly void, or varied, either from the commencement of the contract or from some other time.
>
> (4) In considering whether a contract is unfair because it is against the public interest, the matters to which the Commission is to have regard must include the effect that the contract, or a series of such contracts, has had, or may have, on any system of apprenticeship and other methods of providing a sufficient and trained labour force.
>
> (5) In making an order under this section, the Commission may make such order as to the payment of money in connection with any contract declared wholly or partly void, or varied, as the Commission considers just in the circumstances of the case.
>
> (6) In making an order under this section, the Commission must take into account whether or not the applicant (or person on behalf of whom the application is made) took any action to mitigate loss.

In applying this section the Commission has emphasised that a claim of unfairness under the section would need to be considered by reference to the conduct of the parties and their individual circumstances. For example, in *Port Macquarie Golf Club Ltd v Stead*, the Full Bench of the Commission stated that:

> The nature and degree of the unfairness . . . as a matter of law, relates to ordinary standards of fairness by directing attention to the particular circumstances of the individual contract or arrangement concerned. Whether or not a contract or arrangement is unfair is a matter to be decided upon examination of the facts of each particular case: *Incitec Ltd v Barry* (1992) 45 IR 148 at 154; and *Baker v National Distribution Services Ltd* (1993) 50 IR 254 at 270.
>
> . . .

> The test of unfairness involves the commonsense approach characteristic of the ordinary juryman by applying standards providing a proper balance or division of advantage or disadvantage between the parties who have made the contract or arrangement, bearing in mind the conduct of the parties, their capability to appreciate the bargain they have made and their comparative bargaining positions when entering into the contract or arrangement; *Davies v General Transport Development Pty Ltd* (1967) 67 AR (NSW) 371 at 374; *A & M Thompson Pty Ltd v Total Australia Ltd* [1980] 2 NSWLR 1 at 13 and *Baker* at 271.[20]

While the Commission has taken a broader approach to the question of unfairness under s 106 than have the courts under the other statutory concepts of unconscionability discussed above, a Commission finding of unfairness does still very much depend on reviewing the conduct of the parties having regard to the facts of the individual case.

Overall, therefore, the courts have not only adhered to their procedural unconscionability bias when applying the existing statutory concepts of unconscionable conduct, but have refused to use these statutory concepts to deal with claims based solely on allegations that a contractual term goes beyond what is reasonably necessary to protect the legitimate interests of the stronger party. In short, unless there is an element of procedural unconscionability, the existing statutory prohibitions against unconscionable conduct will continue to be of little or no value in dealing directly with allegedly unfair contractual terms.

New directions in dealing with unfair terms in franchise agreements

Once it is recognised that the courts have refrained from using existing judicial and statutory notions of unconscionable conduct to consider allegations based solely on the unfairness of contractual terms, the question arises as to whether or not a suitable statutory framework could be developed to deal directly and effectively with such allegations. In dealing with this question, the recent adoption of a new statutory framework by the United Kingdom and the Australian State of Victoria to deal with unfair terms in consumer contracts provides very useful guidance as to how such a new framework could be developed within a commercial context like franchising.

Significantly, both the UK and Victorian frameworks begin with a definition of what constitutes an unfair term. The inclusion of a clear definition would be critical in any framework involving business to business contracts like franchise agreements. In both legislations unfair terms are defined primarily by reference to the concept of good faith and a significant imbalance in the contractual rights and obligations of the parties to the detriment of the consumer. While the two pieces of legislation have these common elements to the definition of an unfair term, there are some differences in the definitions. For example, the UK framework targets unfair terms in standard form contracts, while the Victorian framework targets unfair terms in consumer contracts generally. In particular, under reg 5 of the UK framework the focus is on terms not individually negotiated by the parties:

---

20 (1996) 64 IR 53 at [5]–[7].

(1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.
(2) A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.
(3) Notwithstanding that a specific term or certain aspects of it in a contract has been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of it indicates that it is a pre-formulated standard contract.
(4) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.

This regulation also includes a number of safeguards to ensure that only genuinely negotiated terms will be considered to be individually negotiated, with the onus falling on the seller or supplier. In comparison, s 32W of the Victorian framework refers to a consumer contract which can include both standard and individually negotiated terms:

> A term in a consumer contract is to be regarded as unfair if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.

Although the framework does not directly exclude individually negotiated terms from its coverage, the issue of whether the term is individually negotiated remains, along with other matters, a factor to be taken into account by the court or tribunal under the Victorian framework. This list of factors is found in s 32X and is particularly noteworthy as it provides a valuable guide to the types of terms that may be considered unfair under the Victorian framework:

> **32X Assessment of unfair terms**
> Without limiting section 32W, in determining whether a term of a consumer contract is unfair, a court or the Tribunal may take into account, among other matters, whether the term was individually negotiated, whether the term is a prescribed unfair term and whether the term has the object or effect of —
> (a) permitting the supplier but not the consumer to avoid or limit performance of the contract;
> (b) permitting the supplier but not the consumer to terminate the contract;
> (c) penalising the consumer but not the supplier for a breach or termination of the contract;
> (d) permitting the supplier but not the consumer to vary the terms of the contract;
> (e) permitting the supplier but not the consumer to renew or not renew the contract;
> (f) permitting the supplier to determine the price without the right of the consumer to terminate the contract;
> (g) permitting the supplier unilaterally to vary the characteristics of the goods or services to be supplied under the contract;
> (h) permitting the supplier unilaterally to determine whether the contract had been breached or to interpret its meaning;
> (i) limiting the supplier's vicarious liability for its agents;

(j) permitting the supplier to assign the contract to the consumer's detriment without the consumer's consent;
(k) limiting the consumer's right to sue the supplier;
(l) limiting the evidence the consumer can lead in proceedings on the contract;
(m) imposing the evidential burden on the consumer in proceedings on the contract.

A similar list is provided in Sch 2 of the UK Regulations. The following terms are listed in the UK framework as being an indicative and non-exhaustive list of the terms which may be regarded as unfair:

1 Terms which have the object or effect of —
(a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
(b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
(c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
(d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
(e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
(f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
(g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
(h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early;
(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
(k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
(l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
(m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;

(n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
(o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
(p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
(q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

2 Scope of paragraphs 1(g), (j) and (l)

(a) Paragraph 1(g) is without hindrance to terms by which a supplier of financial services reserves the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.
(b) Paragraph 1(j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.
Paragraph 1(j) is also without hindrance to terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.
(c) Paragraphs 1(g), (j) and (l) do not apply to:
- transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;
- contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency;

(d) Paragraph 1(l) is without hindrance to price indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

Where a term is found to be unfair, reg 8 of the UK framework provides that: (i) the term will be unenforceable against the supplier, and (ii) the remainder of the contract is binding provided it can continue without the unfair term. Under s 32Y of the Victorian framework an unfair term in a consumer contract is void, with the contract also continuing to bind the parties where it is capable of existing without the unfair term.

While both the UK and the Victorian framework directly target unfair terms and provide important guidance as to what may be regarded as an unfair term, the Victorian framework goes a step further by providing that not only can a term be prescribed as unfair, but that such a prescribed unfair term will be void under s 32Y when used in a standard form contract. Within this context, s 32U

of the Victorian framework defines a 'prescribed unfair term' as 'a term that is prescribed by the regulations to be an unfair term or a term to the like effect', and a 'standard form contract' is defined as 'a consumer contract that has been drawn up for general use in a particular industry, whether or not the contract differs from other contracts used in that industry'. Under s 32Z it also becomes an offence for a supplier to either use or enforce against a consumer a prescribed unfair term in a standard form contract. Thus, not only does the Victorian framework take a firm position against prescribed unfair terms, but by allowing for the prescription of unfair terms it has established a valuable mechanism for dealing swiftly and effectively with unfair terms.

In summary, the UK and Victorian frameworks aim to provide a targeted mechanism for dealing directly with unfair terms in contracts. Indeed, dealing with unfair terms in a consumer context is the sole focus of both frameworks and this allows the enforcement agency in the particular jurisdiction to go after such terms in a direct manner. In doing so, the enforcement agency has the ability to directly approach sellers and suppliers and seek their cooperation in modifying a term perceived to be unfair under the terms of the particular framework. Although a cooperative approach has been used in the overwhelming majority of cases, the enforcement agency in each jurisdiction is given sufficient powers to take enforcement action against the continued use of the allegedly unfair term. There can be no doubt that this ability under the UK and Victorian framework to pro-actively deal with unfair contractual terms in a timely manner is of considerable benefit to consumers. Not only do these regulatory frameworks seek to clearly define the nature of an unfair term covered by the framework and provide examples of the type of terms likely to be unfair, but each framework empowers the enforcement agency to take appropriate action to prevent the continued use of the allegedly unfair term.

While clearly the UK and Victorian frameworks are aimed at unfair terms in consumer contracts, a review of these frameworks reveals a number of elements that could form part of a new legislative framework for dealing with allegedly unfair terms in business to business contracts involving small businesses. These elements include:

- a clear definition of what constitutes an unfair term;
- be solely focused on substantive unfairness;
- provide a comprehensive listing of potentially unfair terms;
- contain an ability to prescribe terms accepted as being unfair;
- impose a penalty for using a prescribed unfair term;
- have a well resourced government agency enforcing the legislative framework;
- provide guidance and education to the parties covered by the legislative framework;
- allow for enforceable undertakings to be provided to the government agency;
- allow for advisory opinions by a quasi-judicial body as to whether a term is unfair under the legislative framework;
- enable private enforcement by the small business;
- require plain English drafting of contracts; and
- allow for advisory opinions by the government agency.

Such elements would allow the legislative framework to deal with allegedly

unfair contract terms in a direct and targeted manner. In doing so, they enable the framework to provide a readily accessible and transparent mechanism for identifying and dealing with unfair terms in business to business contracts involving small businesses. Importantly, the elements allow the new regulatory framework to respond to unfair terms in a way that has not been possible under the equitable doctrine of unconscionability and the existing statutory prohibitions against unconscionable conduct. In short, it is the combination of the identified elements that would allow the new legislative framework to respond to unfair terms in a direct and measured manner.

Concluding remarks

With the growing disparity of bargaining power between small businesses and the larger businesses with which they deal, it is tempting for larger business to draft terms that are not only favourable to that larger business but go further in tilting the balance of contractual rights and obligations significantly in favour of the larger business. That terms may be favourable to the larger business is to be expected. Of course, the larger business is entitled to include terms that are reasonably necessary to protect its legitimate interests. To go beyond that, however, runs the risk that contracts are being used in an oppressive or exploitative manner. As small business dealing with such larger businesses are ordinarily contractually captive and have little or no ability to prevent the larger party from changing the terms of the contract during the course of the contract, it is clear that, in the absence of any legislative or judicial restriction against the use of unfair terms, the larger business is effectively left to its own devices in deciding whether or not to go beyond what is reasonably necessary to protect its interests. While clearly some larger businesses will show self-restraint, there are those corporations which will always seek to increasingly push the boundaries in their favour. With the equitable doctrine of unconscionability and the existing statutory provisions against unconscionable conduct having a procedural unconscionability bias, it is readily apparent that these existing judicial and legislative mechanisms are of extremely limited use where the small business concern relates solely to the substantive unfairness of a contractual term. Indeed, with existing mechanisms typically only relevant where there is procedural unconscionability or, at least a mixture of procedural and substantive unconscionability, a new legislative framework may be needed to deal directly with unfair terms in business to business contracts involving small businesses. If such a new legislative framework is to be implemented it must be targeted in its operation and provide clear guidance as to what constitutes an unfair contractual term.

Australian Franchising Disputes: An Examination of Causes and Remedies since 1998

Frank Zumbo
Associate Professor
University of New South Wales
Sydney, NSW, 018
Australia
Tel: +61 2 9385 3259
E-mail: F.Zumbo@unsw.edu.au

Presented at the 21th Annual
International Society of Franchising Conference
Caesar's Palace
Las Vegas, Nevada
February 23-25, 2007

Australian Franchising Disputes: An Examination of Causes and Remedies since 1998

Abstract

With the enactment in 1998 of Australia's mandatory Franchising Code of Conduct (Franchising Code) and a broader legislative prohibition against unconscionable commercial conduct as part of the Australian *Trade Practices Act* (the TPA) a new and wide-ranging regulatory framework was introduced in Australia to deal with a variety of franchising disputes. These changes, along with the long standing legislative prohibition against misleading or deceptive conduct also found in the TPA, have meant that the TPA's operation is central to the identification and resolution of many types of Australian franchising disputes. Indeed, not only do many Australian franchising disputes arise from the application of the TPA, the TPA - through such things as the mediation of franchising disputes as mandated by the Franchising code - offers an important mechanism for the timely resolution of Australian franchising disputes. Within this context, the paper will begin by outlining the regulatory framework since 1998 for dealing with Australian franchising disputes involving the TPA. The paper will then proceed to examine the causes of these franchising disputes and the ways in which such disputes have been handled by the Australian Competition and Consumer Commission (the ACCC) - the body responsible for administering and enforcing the new regulatory framework. In doing so, the paper will offer an analysis of publicly available information regarding the ACCC's handling of franchising disputes since 1998.

Key words

Australia, disputes, causes, regulatory framework, dispute resolution

Introduction

With the enactment in 1998 of Australia's mandatory Franchising Code of Conduct (Franchising Code) and a broader legislative prohibition against unconscionable commercial conduct as part of the Australian *Trade Practices Act* (the TPA) a new and wide-ranging regulatory framework was introduced in Australia to deal with a variety of franchising disputes. These changes, along with the long standing legislative prohibition against misleading or deceptive conduct also found in the TPA, have meant that the TPA's operation is central to the identification and resolution of many types of Australian franchising disputes. Indeed, not only do many Australian franchising disputes arise from the application of the TPA, the TPA - through such things as the mediation of franchising disputes as mandated by the Franchising code - offers an important mechanism for the timely resolution of Australian franchising disputes. Within this context, the paper will begin by outlining the regulatory framework since 1998 for dealing with Australian franchising disputes involving the TPA. The paper will then proceed to examine the causes of these franchising disputes and the ways in which such disputes have been handled by the Australian Competition and Consumer Commission (the ACCC) - the body responsible for administering and enforcing the new regulatory framework. In doing so, the paper will offer an analysis of publicly available information regarding the ACCC's handling of franchising disputes since 1998.

Legislative framework for dealing with Australian franchising disputes – Key elements since 1998

In 1998 a number of substantial additions were made to the legislative framework governing Australian franchising disputes. These additions involved a Franchising code and broader legislative prohibition against unconscionable commercial conduct. Not only have these additions placed particular aspects of the franchising relationship under the spotlight, but they have also provided franchising participants with new avenues for resolving disputes. In doing so, these additions have, along with earlier legislative initiatives, become key causes of and remedies for Australian franchising disputes

A mandatory Franchising Code of conduct

The Franchising Code applies to all franchise agreements entered into, transferred, renewed or extended on or after 1 October 1998.[1] Since that time the Franchising Code has taken centre stage with respect to the causes of and remedies for Australian franchising disputes. The Franchising Code is made up of four parts and two annexures dealing with the content of disclosure documents required under the Franchising Code. The four parts cover (i) preliminary issues such as the Franchising Code's application, (ii) disclosure requirements, (iii) conditions of the franchise agreement and (iv) dispute resolution.[2] The Franchising Code imposes important requirements on franchisors and because it is mandatory under the TPA a breach of the Franchising Code represents a breach of the TPA and subject to remedies under the TPA. Increasingly, it is the alleged failure by the franchisor to comply with these requirements that forms the basis of franchising disputes, especially disputes in which the ACCC has become involved. Significantly, the Franchising Code also promotes the use of mediation as a key remedy in the resolution of Australian franchising disputes.

Disclosure requirements

The issue of disclosure is undoubtedly central to the Franchising Code's operation. In Part 2 of the Franchising Code, franchisors are required to provide franchisee with a disclosure document setting out the required information to be provided to franchisees. Under Annexure 1 of the Franchising Code a franchisor providing a full disclosure document is required to provide information to franchisees under the following headings:

- First page
- Franchisor details
- Business experience
- Litigation
- Payments to agents

[1] The Code is given legal effect through the *Trade Practices (Industry Codes - Franchising) Regulations 1998*. It is a mandatory code under the *Trade Practices Act 1974* and can be enforced either privately by franchisees or by the Australian Competition and Consumer Commission.
[2] See generally Zumbo F., "Complying with the new Code" (October 1998) 36 (9) Law Society Journal 46.

- Existing franchises
- Intellectual property
- Franchise site or territory
- Supply of goods or services to a franchisee
- Supply of goods or services by a franchisee
- Sites or Territories
- Marketing or other cooperative funds
- Payments
- Financing
- Franchisor's obligations
- Franchisee's obligations
- Summary of other conditions of agreement
- Obligation to sign related agreements
- Earnings information
- Financial details
- Updates
- Other relevant disclosure information
- Receipt

The range of information required to be disclosed is comprehensive and a franchisor's alleged failure to disclose the required information has emerged as key cause of Australian franchising disputes since 1998.

Conditions of Franchise Agreement

Part 3 of the Franchising Code imposes a number of additional obligations concerning the operation of the franchise agreement. These obligations require a franchisor to:

- allow a cooling off period when a franchise agreement is entered into by a franchisee;
- give a copy of a lease to franchisees where they lease premises from the franchisor;
- allow franchisees to associate with each other for lawful purposes;

- refrain from seeking from a franchisee a general release from liability;
- organise the preparation and audit of financial statements for a marketing fund;
- to disclose a number of materially relevant facts;
- to refrain from unreasonably withholding consent to the transfer of the franchised business; and
- take certain steps in relation to a termination of the franchise agreement.

These additional obligations represent a minimum set of standards of conduct required of franchisor in their dealings with franchisees. From time to time a franchisor's alleged failure to comply with these obligations has given rise to disputes with the Australian context.

Resolving Australian franchising disputes – Part 4 of the Franchising Code and role of mediation

The provision of a low cost, effective dispute resolution process is another key objective of the Franchising Code. With concerns that litigation is costly and not conducive to the preservation of the franchising relationship, the Franchising Code provides franchising participants with an alternative dispute resolution framework. In doing so, the Franchising Code has not only attempted to provide a simple procedure for the parties to follow in the event of a dispute, but it has also emphasised the use of mediation for the resolution of franchising disputes.[3] Indeed, although the parties are able to decide the method by which they will resolve a dispute, a failure to agree on such a method will mean that either party can refer the matter to a mediator. More importantly, where the parties cannot agree on a mediator, the parties can approach the Government-appointed mediation adviser to select a suitable mediator.

The nature of Mediation

Mediation involves a process of negotiation between the parties in which an independent and neutral third party - the mediator - assists the parties in identifying and exploring options for settling the dispute. While the focus is on the parties settling the dispute, the mediator has a vital role in bringing the parties together and helping them understand the other party's

[3] For a further discussion regarding mediation under the Code see Zumbo F, "Scenarios for mediating franchising disputes," (December 2000) 38 (11) LSJ 68.

position. The mediation process is informal and centres on the mediator helping the parties to identify what is a reasonable outcome for them in the circumstances. In doing so, the mediator will give the parties an opportunity to describe the problem as they see it and, on occasion, will meet separately with the parties with the aim of clarifying key issues and/or trying to bring the parties closer together on such issues.

Mediation under the Franchising Code

The dispute resolution procedure outlined under Part 4 of the Franchising Code is initiated by a party - described as the *complainant*[4] - informing the other party in writing about the nature of the dispute, the desired outcome and what action is believed to be required to settle the dispute.[5] This written notice is aimed at assisting the parties in identifying the scope of the dispute and the action required to settle the dispute. In doing so, the parties should focus on specific issues rather than general complaints. In drafting this written notice, the parties may use the `Notice of Dispute' found on the Office of the Mediation Adviser's website.[6] That Notice of Dispute draws from the Franchising Code's requirements and provides a brief, plain english, description of those requirements.

Once the written notice is given, the parties should try to agree on how to resolve the dispute.[7] While the parties may settle the dispute during this period, it may be more realistic to expect that this period will be spent trying to reach an agreement on the particular dispute resolution process to be followed by the parties. By requiring the parties to come to an agreement on how to resolve the dispute, the procedure under the Franchising Code is, at the very least, seeking to promote continued dialogue between the parties. If the dispute can be settled at this point, then the dialogue has achieved its goal.

Where, however, the parties cannot agree on an appropriate dispute resolution process within three weeks, either party is able to refer the matter to a mediator.[8] In the event that the parties cannot agree on a mediator, then either party can ask the Office of the Mediation

[4] See clause 24.
[5] See Clause 29(1).
[6] http://www.mediationadviser.com.au
[7] See Clause 29(2).
[8] See Clause 29(3)(a).

Adviser to appoint a mediator.[9] The Mediation Adviser has 14 days in which to appoint a mediator for the dispute.[10]

The parties are required to attend the mediation and attempt to resolve the dispute.[11] While the parties cannot be compelled to settle the dispute, the parties are required to participate in the mediation process. This, however, is not intended to affect a party's right to take legal proceedings under the franchise agreement.[12] It is critical that both parties have the right to seek injunctive relief in appropriate circumstances to safeguard their legal rights.

In addition to the procedure to be followed, the Franchising Code deals with a number of procedural aspects of the mediation process. For example, the Franchising Code provides that the mediator may decide the time and place for mediation.[13] While it is expected that the parties can, at the very least, agree on an appropriate venue for the mediation, the ability of the mediator to decide the venue avoids the difficulties associated with the parties simply not being able to agree on a venue for mediation. After all, ensuring that the parties maintain their dialogue on substantive issues is a key factor in the resolution of franchising disputes.

The Franchising Code also provides that the parties must pay for their own costs of attending the mediation and that, unless otherwise agreed, the parties are equally liable for the costs of mediation under the Franchising Code.[14] Any other procedural aspects, such as the confidentially of the mediation process, will need to be dealt within the franchise agreement or in related agreements.

In 2001 a number of amendments were made in relation to the mediation of Australian franchising disputes.[15] These included:

---

[9] See Clause 29(3)(b).
[10] See Clause 30(1).
[11] See Clause 29(6).
[12] See Clause 31(1).
[13] See Clause 29(5).
[14] See Clause 31.
[15] See *Trade Practices (Industry Codes — Franchising) Amendment Regulations 2001 (No. 1).*

- a requirement that mediation under the Franchising Code be conducted in Australia;[16]
- provision for the mediator, subject to mediation occurring in Australia, to decide the time and place for mediation;[17] and
- a provision to the effect that a party is taken to attend mediation if the party is represented at the mediation by a person who has the authority to enter an agreement to settle the dispute on behalf of the party.[18]

A more significant addition to the dispute resolution part of the Franchising Code involves a new clause 30A dealing with termination of mediation. At it simplest, that clause will apply where at least 30 days have elapsed after the start of mediation of a dispute and the dispute has not been resolved.[19] In those circumstances, the mediator must terminate the mediation if either party asks the mediator to do so.[20] This, however, does not prevent the mediator to terminate the mediation at any time.[21] The Mediator may do so unless satisfied that a resolution of the dispute is imminent. Where the mediator terminates the mediation of a dispute under clause 30A, the mediator must issue a certificate stating the names of the parties, the nature of the dispute, that the mediation has finished, and that the dispute has not been resolved.[22] The certificate is to be provided to the mediation adviser and each of the parties to the dispute.[23]

Mediation Adviser

The provision in the Franchising Code for the Federal Minister for Small Business to appoint a mediation adviser for the purposes of the Franchising Code is a unique feature of the new franchising dispute resolution framework.[24] In particular, since the mediation adviser is required under the Franchising Code to choose a mediator where requested by the parties, the appointment of the mediation adviser will ensure that mediation can occur

[16] See Clause 29(5A).
[17] See Clause 29(5).
[18] See Clause 29(7).
[19] See Clause 30A(1).
[20] See Clause 30A(2).
[21] See Clause 30A(3).
[22] See Clause 30A(4).
[23] See Clause 30A(5).
[24] See Clause 25.

despite the parties not being able to agree on a suitable mediator. Once again, while it is expected that the parties should be able to agree on a suitable mediator, the mediation adviser is, given its extensive alternative dispute resolution experience, well placed in identifying an appropriate mediator.

The Office of the Mediation Adviser - established in late 1998 by the Federal Office of Small Business - has set up a website to provide easy access to the Office and to assist franchising participants in understanding its the role in the event of a dispute.[25] The website provides franchising participants with a very informative plain english introduction to:

- the mediation process;
- the Franchising Code's dispute resolution requirements;
- the role of the Office;
- dispute resolution in general; and
- a number of other useful websites.

The website includes a toll-free telephone number,[26] email[27] and postal address[28] for contacting the Office. An information kit - entitled `Resolving Franchise Disputes' - has also been released with information similar to that on the website.

In short, the mediation adviser has a great deal to offer franchising participants in resolving their dispute through mediation. In doing so, the mediation adviser has played a valuable role in the resolution of Australian franchising disputes since 1998. Importantly, around 70% of disputes handled through the Office of the Mediation Adviser have successfully been resolved. Clearly, mediation has become an important remedy for Australian franchising disputes.

[25] http://www.mediationadviser.com.au
[26] 1800 150 667.
[27] office@mediationadviser.com.au
[28] Suite 205, 370 Pitt Street, Sydney NSW 2000

A legislative prohibition against unconscionable conduct: s 51AC of the *Trade Practices Act*

The introduction of s 51AC of the TPA was intended to deal with unconscionable conduct in relation to business relationships involving small businesses. Importantly, franchising relationships were intended to be a prime target of the section. The section itself prohibits "conduct" that is in all the circumstances unconscionable and provides a list of factors that the Courts may consider in determining whether or not the conduct in question is unconscionable. The key provisions of the s 51AC have been included in Appendix 1.

At its simplest s 51AC is concerned with the overall conduct of one franchising participant towards another rather than merely the terms of a franchise agreement. Thus while the factors listed in s 51AC raise both procedural and substantive unconscionability issues, in practice there has been a natural inclination by Australian Courts to emphasize procedural unconscionability (or the overall conduct of the offending party) in cases under s 51AC.

Indeed, the Courts have noted that the terms of a contract cannot, on their own, form the basis of an action under s 51AC. In the words of the Full Federal Court in *Hurley v McDonald's Australia Ltd* [1999] FCA 1728 something more is required than merely pointing to the terms of the contract:

> "24 No allegation of unconscionable conduct is made in … relation to the making of the alleged contracts between McDonalds, on the one hand, and the Applicant and the group members, on the other. The allegation is simply that it would be unconscionable for McDonalds to rely on the terms of such contracts.
>
> …
>
> 29 There is no allegation of any circumstance that renders reliance upon the terms of the contracts unconscionable. For example, it might be that, having regard to particular circumstances it would be unconscionable for one party to insist upon the strict enforcement of the terms of a contract. One such circumstance might be that an obligation under a contract arises as a result of a mistake by one party. The

> mistake is an additional circumstance that might render strict reliance upon the terms of the contract unconscionable. Mere reliance on the terms of a contract cannot, without something more, constitute unconscionable conduct.
>
> …
>
> 31 Before sections … 51AC will be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract *`unfair'* or *`unreasonable'* or *`immoral'* or *`wrong'*."

In short, 51AC is concerned with the conduct of the parties to a franchise agreement and cannot be used by a party to prevent the enforcement of a contractual term unless there is some additional circumstance arising from the particular case that would render the enforcement of that term unconscionable. Despite this important limitation on the operation of s 51AC allegations of unconscionable conduct have become a key cause of Australian franchising disputes since 1998.

Other legislative provisions relevant to Australian franchising disputes

The new legislative provisions introduced in 1998 are in addition to two longstanding legislative provisions relevant to Australian franchising disputes. The first of these is the prohibition against misleading or deceptive conduct found in s 52 of the TPA:

> "(1) A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."

This provision against misleading or deceptive conduct has a very wide ambit covering all commercial conduct that leads or is capable of leading into error[29] and can extend to omissions[30] as well as to misrepresentations.[31] Given the potential width of s 52's

[29] See *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 198; and *Johnson Tiles Pty Ltd v Esso Australia Ltd* (2001) ATPR 41-794 at 42,546.
[30] See, for example, the observations of the Full Court of the Federal Court of Australia in *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd* (No 1) (1988) 39 FCR 546 per Lockhart J at 556-557. See also *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31 at 32 and *Kimberley NZI Finance Ltd v Torero Pty Ltd* (1989) ATPR (Digest) 46-054 at p 53, 195.
[31] See *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177 at 202 and see *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177 at 202.

operation, it is not surprising to find that this legislative provision has been a central element in many Australian franchising disputes.

The longstanding prohibition against misleading or deceptive conduct has stood along side s 106 of the *Industrial Relations Act 1996* (NSW), a New South Wales provision that (along with its predecessors) has given the Industrial Commission of New South Wales in Court Session (the Commission) the power to deal with an `unfair contract' in very specific circumstances. The key provisions of the s 106 have been included in Appendix 2. Importantly, this provision has given the Commission the power to consider claims of unfairness within a franchising context by reference to the conduct of the parties and their individual circumstances. For example, in *Port Macquarie Golf Club Limited v Stead* (1995) 64 IR 53, the Full Bench of the Commission (at 59) stated that:

> "5. The nature and degree of the unfairness … as a matter of law, relates to ordinary standards of fairness by directing attention to the particular circumstances of the individual contract or arrangement concerned. Whether or not a contract or arrangement is unfair is a matter to be decided upon examination of the facts of each particular case**:** *Incitec Limited v Barry* (1992) 45 IR 148 at 154; and *Baker v National Distribution Services Limited* (1993) 50 IR 254 at 270.
>
> ...
>
> 7. The test of unfairness involves the commonsense approach characteristic of the ordinary juryman by applying standards providing a proper balance or division of advantage or disadvantage between the parties who have made the contract or arrangement, bearing in mind the conduct of the parties, their capability to appreciate the bargain they have made and their comparative bargaining positions when entering into the contract or arrangement; *Davies v General Transport Development Pty Limited* (1967) 67 AR (NSW) 371 at 374; *A & M Thompson Pty Limited and Others v Total Australia Limited* [1980] 2 NSWLR 1 at 13 and Baker at 271."

While the Commission has taken a broader approach to the question of unfairness under s 106 than have the courts under s 51AC of the TPA, a Commission finding of unfairness

has very much depended on reviewing the conduct of the parties having regard to the facts of the individual case. Despite this s 106 has long played an important part in disputes involving claims of unfairness regarding franchise agreements in the Australian State of New South Wales.

The ACCC and Australian franchising disputes since 1998

With the enactment of the Franchising Code and a new prohibition against unconscionable commercial conduct under the TPA, the ACCC's potential involvement in franchising disputes was considerably expanded. These new areas of ACCC involvement are in addition to the longstanding powers to deal with misleading or deceptive conduct within a franchising context.

To assist in understanding the nature of Australian franchising disputes and the ACCC's involvement in such disputes since 1998, it is useful to consider franchising cases pursued by the ACCC during that time. This can be done at three levels. Firstly, an analysis can be undertaken on a year by year basis of publicly available information regarding franchising cases pursued by the ACCC since 1998. Such publicly available information includes ACCC media releases and other information available from the ACCC's website.[32] Secondly, by outlining the types of allegations involved in franchising disputes that have come before the ACCC. Finally, a number of in depth cases studies can be used to illustrate how franchising disputes may, at times, have a number of facets, especially since 1998.

The ACCC and Australian franchising disputes since 1998: A year by year breakdown of cases

A review of the ACCC media releases and other publicly available material on its website provides valuable insight into the nature and incidence of Australian franchising disputes since 1998. Table 1 summaries the types of franchising disputes that have come before the ACCC by reference to allegations relating to (i) misleading or deceptive conduct

[32] www.accc.gov.au

under primarily s 52 of the TPA; (ii) unconscionable conduct under primarily s 51AC of the TPA; (iii) breaches of the Franchising Code.

From the outset, it needs to be noted that Table 1 only considers cases investigated by the ACCC and which have been resolved through either through litigation or undertakings provided to the ACCC to settle the particular case. Accordingly, Table 1 should be seen as representative of the types of franchising disputes that have come before the ACCC since 1998. While some of the cases referred to in Table 1 and the case studies may have gone through mediation at some point, this information is not publicly available as mediation is generally a confidential process.

In the absence of publicly available data regarding the types of franchising disputes that are dealt with through mediation, the publicly available information about cases dealt with by the ACCC represents a valuable source of reliable data regarding the causes of Australian franchising disputes since 1998 as well as the remedies available to deal with such disputes. Thus, while it is generally known that mediation has been successful in resolving around 70% of Australian franchising disputes, there is an absence of generally available data regarding those mediations and we are left to look for alternative sources of reliable and publicly available data regarding Australian franchising disputes. One such alternative source is data obtained from the ACCC website and considered below.

Turning to the ACCC data, it is important to note that most cases considered by the ACCC have typically raised more than one issue. For example, allegations of misleading or deceptive conduct have often been accompanied by alleged breaches of the Franchising Code. Accordingly, the table sets out the total number of cases in a specific year followed by the number of cases in which the particular type of allegation was identified in the ACCC media release or other publicly available information from the ACCC website. Finally, it should be noted that while a number of media releases may have been issued in relation to a particular case, the case is included only once in the Table 1. For the sake of consistency, each case is included only in the year in which the allegations were first made public by the ACCC.

Table 1 gives a year by year breakdown of the number of cases considered by the ACCC in that year as well as the general nature of the dispute:

Table 1:

Year	Total number of cases	Misleading or deceptive conduct	Unconscionable Conduct	Franchising Code
1998	2	2		
1999	6	4	2	2
2000	1	1		
2001	2	1	2	1
2002	4	3	4	3
2003	1	1		1
2004	3	2		3
2005	4	4		4
2006	3	2		2

The ACCC and Australian franchising disputes since 1998: An analysis of the causes of franchising disputes that come before the ACCC

It is readily apparent that allegations involving misleading or deceptive conduct and Franchising Code breaches are the most common causes of Australian franchising disputes pursued by the ACCC since 1998. In view of the width of the prohibition against misleading or deceptive conduct it is not surprising to find that allegations of such conduct have often been a central part of ACCC cases. In particular, alleged misleading or deceptive conduct regarding particular aspects of the franchise business, including the

franchise's potential profitability or return on investment were recurring themes in ACCC cases.

In contrast allegations of unconscionable conduct have not been as prevalent, especially in more recent years. This may be explained by the difficulty of establishing unconscionable conduct claims in the light of the strict view taken by Australian courts on what constitutes unconscionable conduct. For example, the judicial emphasis on the need to show a high degree of procedural unconscionability makes unconscionable conduct allegations difficult to sustain.

In relation to the alleged breaches of the Franchising Code, it appears that a failure to fully comply with the disclosure obligations under the Franchising Code has also been a recurring theme in ACCC cases. Overall, therefore, cases pursued by the ACCC can be seen as representative of the type of issues that have given rise to Australian franchising disputes since 1998.

The ACCC and Australian franchising disputes since 1998: An outline of the types of allegations involved in franchising disputes that have come before the ACCC

In this section of the paper a list is provided of the types of allegations that have come before the ACCC in franchising cases since 1998. Once again, the list is drawn from information publicly available on the ACCC website. The list is intended to give an overview of some of the causes of Australian franchising disputes since 1998. The allegations made by franchisees against franchisors since 1998 in cases before the ACCC include:

Alleged breaches of the Franchising Code

- The franchisor allegedly failing to comply with the requirements of the Franchising Code including:
    - failing to provide franchisees with a disclosure document;

- providing documents that were purportedly disclosure documents but which failed to comply with the requirements of the Code;
- providing earnings information that was not based on reasonable grounds;
- failing to provide franchisees with a 7 day-cooling off period;
- preventing prospective franchisees from associating with and contacting other franchisees;
- failing to request written statements from prospective franchisees that they had/had not received independent advice;
- failing to provide an internal complaint handling procedure in agreements; and
- not providing a reasonable timeframe to remedy alleged franchisee breaches or providing sufficient details of the alleged franchisee breaches and the remedial steps needed to be taken by the franchisee.

Alleged misleading conduct by franchisor

- The franchisor allegedly misrepresenting:
  - the provision of exclusive territories;
  - that franchisees would or could earn high incomes from repeat business and did not have to engage in selling activities in order to successfully operate the particular franchise;
  - that the franchisee would never run out of customers because they could purchase as many customers as they wished from the franchisor;
  - that the franchisor had successfully conducted a business of the type offered to franchisees and the products to be supplied to franchisees performed satisfactorily in all the areas where the franchises were offered for sale;
  - that after an initial training period the franchisees were guaranteed minimum payments or returns on investment;
  - that the franchisor would conduct a national TV, radio and magazine campaign sufficient to make the franchise brand a substantial competitor to existing major brands,

- that a “distribution agreement” was not a franchise;
- the origins, trading history, customer base and profitability of the franchise;
- the training levels to be provided before and during the operation of the franchised business;
- the length of time the franchisor had been operating the franchise;
- the number of customers serviced by the franchise;
- the number of final judgments made against the franchisor in civil proceedings;
- that the franchisor had not been involved an insolvency;
- the potential earnings of the franchisee and the profitability of the franchise business;
- the extent of the existing and potential markets for the franchise products;
- the amount the franchisor would spend on marketing and advertising;
- that the franchise could be operated by anyone despite the legal requirement that only a suitable qualified person could offer the services to be provided by the franchise;
- the experience required to run a fast food franchise;
- the business support and training to be provided;
- the capital that would reasonably be required to operate the franchise and the nature and cost of the fit-out of the premises;
- the lifestyle to be expected by a franchisee including working hours;
- that no previous business operated by a franchisee under the franchise had failed;
- that all work for the franchisee would be referred from the franchisor and that franchisees would only have to do minimal canvassing for customers; and;
- that particular franchise sites would be suitable for the franchise business.

Alleged unconscionable conduct by the franchisor

- The franchisor acted in an allegedly unconscionable manner by:

- targeting people with little or no experience in running a business;
- imposing conditions that were not reasonably necessary for the protection of the legitimate interests of the franchisor;
- failing to ensure franchisees understood important terms of the franchise agreement;
- threatening to terminate the franchise agreement in response to queries by the franchisee;
- demanding the return of the work vehicle used by the franchisee in the franchise business on one day's notice;
- refusing to supply goods to the franchisee needed in the franchise business;
- terminating the franchise agreement and demanding the franchisee, within two business days, return all goods in the franchisee's possession that were supplied by the franchisor, and that the franchisee within five business days, pay all monies claimed to be owing in connection with the franchise;
- terminating a franchise over a dispute about the non payment of a relatively small amount of money by the franchisee;
- threatening to terminate franchisees rather than negotiating disputes about issues such as monies owed and requiring franchisees to attend seminars unrelated to franchise business;
- threatening to suspend franchisees about issues such as associating with other franchisees;
- refusing to deliver franchised products to franchisees;
- deleting the telephone numbers of franchises from a Telephone Directory Assistance Service without the consent or the knowledge of the franchisees;
- unreasonably refusing requests from the franchisees to negotiate matters in dispute with the franchisor and to discuss matters of concern to the franchisees; and

- producing and distributing advertising and promotional material that omitted the names of the franchisees and their franchised businesses.

It is readily apparent that a very wide range of allegations have been made in franchising cases considered by the ACCC since 1998. Importantly, these reveal the importance of franchisors ensuring that any representations made regarding the franchise or any aspects of its operation are accurate and based on reasonable grounds. They also appear to suggest that disputes are more likely to arise where franchisees believe that that they have been given inadequate information about the franchise business or where franchisees perceive franchisors to be "heavy-handed" towards them.

The ACCC and Australian franchising disputes since 1998: Selected case studies

To further illustrate the ACCC's particular involvement in franchising disputes since 1998 a number of case studies have been selected and discussed below. These case studies provide a more in-depth analysis of the impact of the Franchising Code and the prohibitions against misleading, deceptive and unconscionable conduct within a franchising context since 1998. In doing so, however, it should be noted that while these franchising case studies are taken from actions pursued by the ACCC, it must be remembered that franchising participants themselves can take action under the TPA without having to wait for the ACCC to become involved. Indeed, any franchising participant who has been a victim of breaches of the Act may wish to launch their own proceedings seeking, for example, an injunction[33] or damages[34] under the TPA.

In view of both the fact that the ACCC does not pursue all complaints lodged with it and the length of time often taken by the ACCC when it chooses to pursue a case, franchising participants and their advisers may be left to consider whether or not to pursue legal action privately. Even where the ACCC may pursue a matter, it may pursue the matter as

[33] See s 80 of the Act.
[34] See s 82 of the Act.

a breach of the Act in its enforcement capacity rather than by instituting representative actions[35] on behalf of franchising participants seeking to recover damages for their loss.

Thus, while it is not unknown for the ACCC to take representative actions on behalf of a number of franchising participants,[36] it has been more common for the ACCC, when taking its limited number of enforcement actions in the franchising area, to seek a finding of fact[37] from the Court so that the affected franchising participants can bring their own proceedings to recover any loss that they may have suffered from breaches of the TPA.

Finally, while private action can be pursued under the TPA, it should be remembered that mediation is available as an alternative means of dispute resolution within the franchising sector.[38] Indeed, since 1998 mediation has held a central feature in the resolution of Australian franchising disputes, with franchising participants able to seek mediation of disputes and the Federal Government funding the Office of the Mediation Adviser to assist franchising participants with the mediation process where asked to do so.

In this context, the selected ACCC case studies provide valuable insights into the nature of Australian franchising disputes since 1998.

ACCC v Australian Industries Group Pty Ltd[39]

In this case, Australian Industries Group Pty Ltd - a roller shutter company - was ordered by the Federal Court to pay three small business owners compensation totaling $77,594 in relation to declarations by the Court that the company had engaged in unconscionable conduct, breached the Franchising Code and had made false representations about the profitability of the businesses in breach of the TPA.

In particular, the Court found that the company had:

[35] See ss 87(1A) & 87(1B) of the Act
[36] See for example *ACCC v Top Snack Foods Pty Ltd* [1999] FCA 752.
[37] See s 83 of the Act.
[38] See Part 4 of the Code.
[39] See Media Release MR 41/02, 7 March 2002.

- published an advertisement for employment when the position related to a business opportunity;
- breached the Franchising Code in relation to license agreements it made with installers and a dealership;
- made false representations to the prospective licensees about the potential profitability of the installation and dealership businesses; and,
- acted in an unconscionable manner towards its installers.

This case illustrates how disputes can arise where the nature of the opportunity being offered to the public is not clearly identified. While the distinction between employment and business opportunities may be blurred in some instances, it is important to note that a business opportunity inevitably involves a degree of risk as to the profitability and success of the venture. Such risk is a feature of franchise opportunities and, therefore, a dispute may arise where the risk inherent in a franchise opportunity is under-estimated or misrepresented to potential franchisees. Any suggestion that the opportunity is without risk may trigger a dispute under the TPA.

Hand in hand with possible misrepresentations as to the risk or otherwise of business success goes possible misrepresentations as to the potential profitability of the franchise opportunity. While franchising participants need to be mindful of the Franchising Code's requirements in relation to earnings information where given,[40] profitability claims can rise to disputes under s 52 and s 59 (2)[41] of the TPA.

[40] See Item 19 of the disclosure document under Annexure 1 of the Code.
[41] Section 59(2) provides that:

"Where a corporation, in trade or commerce, invites, whether by advertisement or otherwise, persons to engage or participate, or to offer or apply to engage or participate, in a business activity requiring the performance by the persons concerned of work, or the investment of moneys by the persons concerned and the performance by them of work associated with the investment, the corporation shall not make, with respect to the profitability or risk or any other material aspect of the business activity, a representation that is false or misleading in a material particular."

ACCC v Suffolke Parke Pty Ltd[42]

In this case, a master franchisee, in its capacity as landlord to a franchisee, was declared by the Federal Court to have breached the Franchising Code through its refusal to attend mediation, and to have acted unconscionably towards the tenant/franchisee. The master franchisee was, by consent, ordered by the Court to pay $10,000 in compensation to the tenant/franchisee.

By way of background, the master franchisee in this case had, as is common in many franchise relationships, also been the landlord of premises from which the franchisee operated the franchised business. As it happened, the premises in this case also included a separate shop, which the master franchisee had on previous occasions allowed the franchisee to sublet.

Following disputes between the parties over franchising matters, it was alleged that the master franchisee had refused to again sublet the separate shop to the franchisee. This refusal was allegedly in reprisal for complaints made by this franchisee and other franchisees about the master franchisee's conduct in its capacity as master franchisee for the particular franchise system in the Australian State of South Australia. Finally, when the franchisee sought to go to mediation on the issue, as provided for under the Franchising Code, the master franchisee allegedly refused to attend.

This case highlights a number of areas of potential disputation. Firstly, and perhaps the most obvious, is the importance of complying with the Franchising Code. As the Franchising Code sets out a number of defined minimum standards of conduct, a failure to comply can lead to disputes.

Secondly, the case also illustrates the dangers of a franchisor/master franchisee using one commercial relationship, for example, a landlord/tenant relationship, to deal with problems or issues in another commercial relationship between the parties. Thus, if rights under one relationship are used in a way to punish or bully the other party because of a

[42] See Media Release MR 110/02, 8 May 2002.

legitimate disagreement with that other party in another relationship, then the issue arises as to whether the first party is using its contractual or legal power in one relationship to extract a more favourably position than it would have otherwise secured if there had only been one commercial relationship between the parties. This issue is of particular importance to franchising relationships as it is not uncommon for the franchisor to also be the landlord of the franchised business.

ACCC v Kwik Fix franchisor[43]

In this case, the ACCC alleged breaches of the Franchising Code, and breaches of the unconscionable conduct and misleading or deceptive conduct sections of the TPA. In particular, the ACCC alleged that the franchisor misled a franchisee about the purchase price of a franchise, and made false or misleading representations as to the profitability and working hours of franchisees.

The ACCC also alleged that the franchisor engaged in unconscionable conduct by:

- threatening to terminate the franchise agreement in response to queries by the franchisee;
- demanding the return of the van that the franchisee was using on one day's notice;
- refusing to supply goods to the franchisee; and
- terminating the franchise agreement and demanding the franchisee, within two business days, return all goods supplied to him by the franchisor that are in franchisee's possession, and within five business days, pay all monies claimed to be outstanding in connection with the franchise.

Finally, the ACCC alleged that franchisor induced, or endeavoured to induce, the franchisee not to associate with other franchisees for a lawful purpose, failed to provide the franchisee with a disclosure document or copy of the Franchising Code, and failed to meet other requirements of the Franchising Code. Such allegations again raise issues as to what representations are made to potential franchisees about the franchised business and

[43] See Media Release MR 103/02, 3 May 2002.

its potential profitability. Clearly, profitability claims are a danger area for franchise systems and can lead to disputes.

The allegations also raised issues as to the termination of a franchise. Not only do franchisors need to have regard to the provisions of the Franchising Code relating to termination of a franchise agreement,[44] but franchisors need to be mindful of their behaviour when terminating a franchisee. The reasonableness of that behaviour and, in particular, the reasons behind a termination, need to be carefully assessed in order to avoid potential disputes, particularly given that unreasonable, unfair, bullying and thuggish behaviour can amount to unconscionable conduct in breach of the TPA.[45]

Concluding remarks

In view of the often long term nature of franchising relationships, it is not surprising to find that there may be a number of causes of Australian franchising disputes. Since 1998 these causes have often involved allegations of Franchising Code breaches, unconscionable conduct and misleading or deceptive conduct. As these have largely involved alleged breaches of the TPA, it is readily apparent that the operation of the TPA lies increasingly at the heart of Australian franchising disputes, especially since 1998. Clear evidence of the impact of the TPA emerges from a review of the franchising cases pursued by the ACCC since 1998. Those cases reveal that alleged failures by franchisors to comply with the Franchising Code, along with alleged unconscionable or misleading or deceptive conduct by franchisors are now some of the most likely causes of Australian franchising disputes. Importantly, the operation TPA not only sheds light on the nature of many Australian franchising disputes, but through the Franchising Code the TPA also promotes the use of mediation as a low cost mechanism for resolving such disputes. By promoting for the use of mediation, the TPA now also provides an important additional remedy for those involved in Australian franchising disputes.

[44] See clauses 21 – 23 of the Code.
[45] See *ACCC v Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365.

APPENDIX 1: Key provisions of s 51AC of the *Trade Practices Act 1974* (Cth) – Unconscionable Conduct in Business Transactions

"(1) A corporation must not, in trade or commerce, in connection with:
  (a) the supply or possible supply of goods or services to a person (other than a listed public company); or
  (b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);
engage in conduct that is, in all the circumstances, unconscionable.

(2) A person must not, in trade or commerce, in connection with:
  (a) the supply or possible supply of goods or services to a corporation (other than a listed public company); or
  (b) the acquisition or possible acquisition of goods or services from a corporation (other than a listed public company);
engage in conduct that is, in all the circumstances, unconscionable.

(3) Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation or a person (the ***supplier*** [46]) has contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the ***business consumer***), the Court may have regard to:
  (a) the relative strengths of the bargaining positions of the supplier and the business consumer; and
  (b) whether, as a result of conduct engaged in by the supplier, the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and
  (c) whether the business consumer was able to understand any documents relating to the supply or possible supply of the goods or services; and
  (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on behalf of the business consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and
  (e) the amount for which, and the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier; and
  (f) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; and

[46] While s 51AC(3) deals with the conduct of suppliers, it should be noted that s 51AC(4) deals with the conduct of acquirers. For present purposes, s 51AC(4) and other subsections of s 51AC related to s 51AC(4) have been omitted.

(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the business consumer acted on the reasonable belief that the supplier would comply with that code; and

(i) the extent to which the supplier unreasonably failed to disclose to the business consumer:

(i) any intended conduct of the supplier that might affect the interests of the business consumer; and

(ii) any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); and

(j) the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; and

(k) the extent to which the supplier and the business consumer acted in good faith.

…

(5) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with:

(a) the supply or possible supply of goods or services to another person; or

(b) the acquisition or possible acquisition of goods or services from another person;

by reason only that the first-mentioned person institutes legal proceedings in relation to that supply, possible supply, acquisition or possible acquisition or refers to arbitration a dispute or claim in relation to that supply, possible supply, acquisition or possible acquisition.

(6) For the purpose of determining whether a corporation has contravened subsection (1) or whether a person has contravened subsection (2):

(a) the Court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and

(b) the Court may have regard to circumstances existing before the commencement of this section but not to conduct engaged in before that commencement.

(7) A reference in this section to the supply or possible supply of goods or services is a reference to the supply or possible supply of goods or services to a person whose acquisition or possible acquisition of the goods or services is or would be for the purpose of trade or commerce.

…

(9) A reference in this section to the supply or possible supply of goods or services does not include a reference to the supply or possible supply of goods or services at a price in excess of $3,000,000, or such higher amount as is prescribed."

APPENDIX 2: The relevant provisions of s 106 of the *Industrial Relations Act 1996* (NSW)

"(1) The Commission may make an order declaring wholly or partly void, or varying, any contract whereby a person performs work in any industry if the Commission finds that the contract is an unfair contract.

(2) The Commission may find that it was an unfair contract at the time it was entered into or that it subsequently became an unfair contract because of any conduct of the parties, any variation of the contract or any other reason.

(2A) A contract that is a related condition or collateral arrangement may be declared void or varied even though it does not relate to the performance by a person of work in an industry, so long as:

(a) the contract to which it is related or collateral is a contract whereby the person performs work in an industry, and

(b) the performance of work is a significant purpose of the contractual arrangements made by the person.

(3) A contract may be declared wholly or partly void, or varied, either from the commencement of the contract or from some other time.

(4) In considering whether a contract is unfair because it is against the public interest, the matters to which the Commission is to have regard must include the effect that the contract, or a series of such contracts, has had, or may have, on any system of apprenticeship and other methods of providing a sufficient and trained labour force.

(5) In making an order under this section, the Commission may make such order as to the payment of money in connection with any contract declared wholly or partly void, or varied, as the Commission considers just in the circumstances of the case.

(6) In making an order under this section, the Commission must take into account whether or not the applicant (or person on behalf of whom the application is made) took any action to mitigate loss."

Are Australia's consumer laws fit for purpose?

Frank Zumbo*

After decades of experience with the consumer protection provisions of the Trade Practices Act 1974 (Cth) and the State and Territory Fair Trading Acts, it is timely to consider whether such laws remain fit for purpose. In doing so, this article will consider whether existing consumer laws have become repetitive and unnecessarily complex to a point where both consumers and businesses struggle to fully appreciate the impact of such laws. In turn, questions arise as to whether consumer laws could be streamlined or made more user friendly and, if so, how this could be achieved in an efficient and cost-effective manner. In this regard, the article explores a number of themes such as the use of plain language drafting; the removal of redundant legislative provisions; mechanisms for promoting fairer consumer contracts, and facilitating greater access to justice.

With the consumer protection provisions of the *Trade Practices Act 1974* (Cth) having been added to in a piecemeal manner during the past three decades, it is timely to put those provisions under the spotlight to assess how well they are promoting consumer welfare. Such an assessment is long overdue and provides an opportunity to explore possible new directions in Australian consumer law. Indeed, while there has been a proliferation of consumer laws over those three decades, it remains unclear as to whether those additional laws have delivered the best possible policy outcomes for consumers. In particular, the question arises as to whether consumers are really benefiting, especially since many of the additional laws are simply repetitive or deal with problem areas in an ad hoc manner. Clearly, it is important that consumer laws not only target identified problem areas in a timely manner, but do so in a cost-effective and efficient way.

In short, consumer laws should be designed to minimise compliance costs and maximise consumer and business understanding of such laws. With this in mind, it is opportune to consider a number of key areas of Australian consumer law to not only assess whether those laws could be streamlined, but to also explore possible new approaches that could deliver consumer policy outcomes more effectively. In doing so, the article will explore the following themes:

- the importance of having clear laws and contracts;
- the importance of plain language drafting;
- the value in removing redundant or repetitive legislative provisions;
- the need to promote fairer consumer contracts;
- regulatory agencies and "class compensation orders"; and
- additional mechanisms for directly empowering consumers.

THE IMPORTANCE OF CLEAR LAWS AND CONTRACTS

There can be no doubt that the effectiveness of Australia's consumer laws very much depends on the clarity of language used in such laws. Similarly, clarity of language is essential to a consumer's ability to understand contracts that it may enter into with suppliers. Too often, however, consumer laws and contracts are written in dense legalese, a trend that has undoubtedly been accelerated by the ever-growing reliance on standard form contracts. Indeed, at times there appears to be a contest to see which supplier can draft the longest, most impenetrable consumer contract. With some consumer contracts running to dozens of pages of repetitive and incomprehensible language, there can be little doubt that such density of language adds unnecessary cost and complexity to consumer dealings. In turn, the density of language acts as a strong disincentive to any consumer wishing to understand the terms of the contract, with the consumer simply told by a salesperson "just sign on the dotted line, it's all standard!"

* Associate Professor, School of Business Law and Taxation, University of New South Wales.

With little or no opportunity to read, let alone comprehend, the terms of densely worded consumer laws or contracts, consumers have little scope to challenge unscrupulous suppliers or to self-enforce their legal rights. Clearly, therefore, an understanding of relevant consumer laws and consumer contracts is a necessary prerequisite to consumers being able to act in their own best interests. In this way, plain language drafting of consumer laws and contracts represents a vital element in the empowerment of consumers without the need for expensive legal advice.

It also benefits suppliers by allowing suppliers and their staff to better understand the operation and impact of consumer laws and contracts, therefore reducing need for legal advice and the likelihood of misunderstandings and disputes between consumers and suppliers. This in turn reduces compliance costs and boosts compliance rates. Ultimately, plain language drafting represents best practice in that a law or contract should be capable of being expressed in plain and intelligible language. To use dense legalese is to risk either the intended meaning of the particular law or contract term being lost in a sea of legal jargon, or the law or contract term going beyond what is necessary or appropriate in the circumstances, bringing with it a real danger that it may need some judicial interpretation in the future.

Given these obvious benefits, it is surprising that plain language has not been adopted more universally in, eg the drafting of contracts. On the positive side, it is noteworthy that some industry sectors have expressly promoted the use of plain language drafting. For example, cl 7.1 of the Australian Communications Industry Forum: *Industry Code ACIF C620:2005 Consumer Contracts*[1] provides that telecommunication contracts are to be written in plain language:

> 7.1 **Plain Language**
>
> 7.1.1 A Supplier must ensure that the terms of a Contract:
>
> (a) are clearly expressed by using words in their plain and ordinary meaning;
>
> (b) are consistent in the use of definitions and other terminology; and
>
> (c) that may have multiple valid interpretations are completely defined and used consistently.
>
> …
>
> 7.1.2 A Supplier must avoid the use of complex definitions or technical terms as far as is reasonably practicable having regard to the subject matter of the Contract.

Significantly, cl 7.2 of the Code provides additional guidance regarding the format and structure of telecommunication contracts so as facilitate a better understanding of such contracts by consumers:

> 7.2 **Format and Structure**
>
> 7.2.1 A Supplier must ensure that the terms of a Contract are available in writing and are legible having regard to the medium and format used.
>
> 7.2.2 A Supplier must take reasonable steps to ensure that any document which contains the material terms of the Contract:
>
> (a) is available in hard copy in a minimum 10 point font by reference to the font size of Times New Roman or equivalent size in any other font or, if also available in electronic format, is capable of being printed in that font size;
>
> …
>
> (b) avoids clauses or paragraphs which are excessive in length;
>
> (c) groups the terms by subject matter or otherwise in a clear and logical order with subheadings;
>
> (d) includes an index or table of contents for the terms where necessary for ease of reference;
>
> (e) avoids excessive cross-referencing and the incorporation of terms from other documents which are not available or accessible to the Consumer at the same time as the document;
>
> (f) ensures the text of the document appears in a colour that contrasts sufficiently with its background; and
>
> …
>
> (g) brings important terms to the attention of Consumers in a manner that is reasonable having regard to the length of the document and subject matter of the Contract.

[1] Australian Communications Industry Forum, *Industry Code ACIF C620:2005 Consumer Contracts*, http://www.acma.gov.au/webwr/telcomm/industry_codes/codes/c620(1).pdf viewed November 2007.

While there are some positive steps being taken towards the adoption of plain language drafting, it is disappointing to find that so many consumer contracts are still being drafted in dense legalese. Such an unwillingness to adopt plain language is unfortunate and appears to reflect a failure of the generally self-regulatory approach in this area. Indeed, while there has been a growing awareness of the value of plain language drafting, legislatures have typically left it to suppliers to decide whether or not to use it in the preparation of consumer contracts. More recently, however, legislatures have required that contracts be written in plain language. For example, reg 7(1) of the *Unfair Terms in Consumer Contract Regulations 1999* (UK) requires that any written term of a contract be expressed in "plain, intelligible language". Interestingly, reg 7(2) provides that, subject to specified exceptions, if there is doubt about the meaning of a written term, then the interpretation which is most favourable to the consumer shall prevail.

Similarly, s 163 of the *Fair Trading Act 1999* (Vic) requires consumer documents to be "clear" and provides an enforcement mechanism to secure compliance:

> 163. Consumer documents to be clear
>
> (1) In this section "consumer document" means:
>
> (a) a consumer contract; or
>
> (b) a statement, notice or other document required by this Act to comply with this section.
>
> (2) …
>
> (3) A consumer document:
>
> (a) must be easily legible; and
>
> (b) to the extent that it is printed or typed, must use a minimum 10 point font; and
>
> (c) must be clearly expressed.
>
> (4) If the Tribunal is satisfied, on application by the Director, that any provision of a consumer contract does not comply with the requirements of this section, the Tribunal may by order prohibit a supplier from using the provision in the same or similar terms in consumer contracts.
>
> (5) A supplier must comply with an order under this section.
>
> 60 penalty units, in the case of a natural person.
>
> 120 penalty units, in the case of a body corporate.

Importantly, both the United Kingdom and Victorian approaches to plain language drafting are seen as integral to promoting fairer consumer contracts. This is particularly obvious in the case of the United Kingdom where the plain language requirement is actually part of the regulatory framework for dealing with unfair terms in consumer contracts. Thus, clarity of language in the drafting of consumer contracts is viewed as important to promoting transparency in contractual dealings whereby consumers are able to read their contracts and fully appreciate the contractual risks that they are being required to accept. In short, unless consumers can read and understand the contract for themselves, they are left entirely at the mercy of an unscrupulous supplier.

REDUNDANT OR REPETITIVE PROVISIONS IN LAWS AND CONTRACTS NEED TO BE REMOVED

The removal of redundant or repetitive provisions in consumer laws and contracts would also greatly assist consumers in understanding and making sense of those laws or contracts. Such provisions undoubtedly add complexity and compliance costs, especially as they make it difficult for consumers and suppliers, and their advisers, to read and comprehend the operation and impact of the laws or contracts. Indeed, any benefits from plain language drafting can easily be reduced or even lost where laws or contracts contain redundant or repetitive provisions. Such provisions can act to discourage consumers, and even suppliers, from reading through the laws or contracts in much the same manner as the use of dense legalese in consumer laws and contracts, and ultimately detract from consumers' ability to act in their own best interests.

In short, a review of consumer laws and contracts to remove redundant or repetitive provisions, along with a requirement to draft consumer laws and contracts in plain language, would go a long way towards making those laws more user-friendly and ensuring that consumers understand the nature of laws and contracts that impact on them on a daily basis. In this regard, the implementation of uniform

consumer laws around Australia, as well as dealing with the repetition found in relation to the unconscionable conduct and false representation provisions of the *Trade Practices Act*, would be a useful start.

UNIFORM CONSUMER LAWS

While for many years constitutional issues meant that State and Territory Fair Trading Acts to complement Pt V of the *Trade Practices Act* were enacted to facilitate a national application of consumer laws, it is clear that those laws have diverged in places over the years. As such inconsistencies add unnecessary complexity and cost for both consumers and businesses, it is timely to explore the possibility of developing a Model Fair Trading Law or Code that individual jurisdictions can adopt or apply. This would ensure that there was one set of consumer laws applicable to all consumers and businesses across Australia. Indeed, a Model Law or Code would remove the repetition arising from a multitude of federal, State and Territory laws, which, while similar to a substantial degree, do differ in parts. Importantly, such a Model Fair Trading Law or Code should be written in plain language and would provide a single point of reference for consumers, businesses and their advisers.

Such a Code must also be drafted in a manner that reflects "best practice" in relation to the consumer protection provisions. Indeed, it should not reflect a "lowest common denominator" approach where protections are watered down to a point where consumers in some jurisdictions receive less protection than is currently the case, to accommodate those jurisdictions that have in some respects lagged behind their counterparts on the consumer protection front. A "best practice" approach requires that Australian consumer laws be modernised to reflect consumer protection initiatives from within Australia and other jurisdictions around the world that have delivered real benefits to consumers. One such highly successful initiative relates to a new legislative framework for dealing with unfair terms in consumer contracts adopted both in the United Kingdom and Victoria.[2] A proposal to incorporate such a new legislative framework within an Australian Model Fair Trading Law or Code is discussed below.

An Australian Model Law or Code could also be made readily available through a well publicised website, which could then be used to provide guidelines and other useful information to consumers and businesses about the Model Law or Code.[3] Such a website could provide a one-stop shop for consumers and businesses and could even be developed to allow a single portal for consumer inquiries and for the lodging of complaints which could then automatically be directed to the relevant consumer agency or agencies. While such an approach could initially operate concurrently with existing websites and more traditional methods of communicating with consumers such as telephones and paper-based materials, it is apparent that as internet usage becomes ever greater, a single, well-known website would provide consumers with a readily accessible and user friendly vehicle for meeting their particular needs. A single Australian Model Fair Trading Law or Code drafted in plain language would, when combined with a single, well-known website, remove repetition in consumer laws and facilitate a better understanding of relevant laws by both consumers and businesses.

DO WE NEED A VARIETY OF PROVISIONS DEALING WITH FALSE OR MISLEADING REPRESENTATIONS OR CONDUCT IN CIVIL PROCEEDINGS?

With the enactment of Pt VC to separately provide for criminal offences relating to false or misleading representations or conduct, the provisions of Div 1 of Pt V of the *Trade Practices Act* dealing with specific false or misleading representations or conduct have been duplicated. While it may be appropriate to set out separately particular types of conduct giving rise to a criminal offence, the question arises as to why the civil equivalents found in Div 1 of Pt V should remain, given that those

[2] See Zumbo F, "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" (2005) 13 TPLJ 70; Zumbo F, "Dealing with Unfair Terms in Consumer Contracts: The Search for a New Regulatory Model" (2005) 13 TPLJ 194; Zumbo F, "Promoting Fairer Consumer Contracts: Lessons from the United Kingdom and Victoria" (2007) 15 TPLJ 84.

[3] One such website already exists and could easily be used to provide ready access to an Australian Model Fair Trading Law or Code and related material: See Consumers Online, http://www.consumersonline.gov.au viewed November 2007.

specific false representations would ordinarily be caught under the generally applicable s 52. For example, in relation to civil proceedings there is a clear overlap between s 52 and s 53, which deals with particular false representations. Given such an overlap and the fact that the false representations covered under s 53 are made criminal offences under Pt VC, there is little, if any, justification to retain s 53 and the other provisions replicated in Pt VC.

In practice, a party alleging misleading representations in a civil action is likely to confine its application to s 52 for the sake of simplicity and seeking to save time and legal costs. In this regard, s 52 would be more than sufficient to pursue allegations of misleading or false representations, which in turn makes the remaining provisions in Div 1 of Pt V somewhat superfluous now that Pt VC is in place for the ACCC to pursue specific false representations as a criminal offence. The removal of these superfluous provisions would streamline the *Trade Practices Act* and ensure that a future Model Fair Trading Law or Code does not contain any repetitive or redundant provisions.

DO WE NEED MORE THAN ONE UNCONSCIONABLE CONDUCT PROVISION IN THE TRADE PRACTICES ACT?

During the past 15 years, there has been a proliferation of provisions dealing with unconscionable conduct. With unconscionable conduct being dealt with at the federal level by ss 51AA-51AC of the *Trade Practices Act*, and ss 12CA-12CC of *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act), questions arise as to whether it is possible to have only one provision dealing with unconscionable conduct. In this regard, a number of points can be made. First, in relation to dividing the prohibition against unconscionable conduct between the *Trade Practices Act* and the ASIC Act, it is readily apparent that the split is an artificial one which not only has the potential to generate demarcation issues or disputes, but is quite unnecessary because it would make considerable sense from a consistency point of view that a sole enforcement agency such as the Australian Competition and Consumer Commission (ACCC) enforce a single prohibition against unconscionable conduct.

Second, there is an unnecessary and potentially very confusing distinction between those provisions such as s 51AA of the *Trade Practices Act* and s 12CA of the ASIC Act which seek to prohibit conduct that is "unconscionable" under "unwritten law", and the other provisions that seek to prohibit conduct that is "in all the circumstances, unconscionable". While, at its simplest, the different use of the word "unconscionable" in each of these sections reflects a distinction between the traditionally very narrow equitable doctrine of unconscionability and the more recent statutory doctrine of unconscionability, such a distinction cannot be readily justified. Not only should there be a single, unified statutory definition of the concept of "unconscionable" in the *Trade Practices Act* or a Model Fair Trading Law or Code, but such a definition could be drafted as a non-exhaustive definition that defines the parameters of the statutory concept while allowing scope for the courts to draw on any useful developments within the equitable doctrine.

Finally, an additional complicating dimension arises from the present distinction between consumer and business transactions. While, originally, the unconscionable conduct provisions of the *Trade Practices Act* were limited to consumer transactions, there was a growing recognition that the unethical practices that led to a statutory concept of unconscionability being enacted for consumers were also prevalent within business-to-business transactions involving small businesses.[4] Indeed, the vulnerability experienced by consumers in dealings with suppliers was sometimes comparable to that experienced by small businesses in their dealings with larger businesses. While initially this led to the enactment of s 51AA of the *Trade Practices Act*, it was soon recognised that the adoption of the concept of "unconscionable" under the "unwritten law" gave no more assistance to small businesses faced with allegedly unethical practices by larger businesses than did the equitable doctrine of unconscionability. This realisation led to s 51AC being enacted, although no attempt was made at the time to rationalise the growing number of unconscionability provisions. Given that s 51AA is now

[4] See Zumbo F, "Unconscionability and Commercial Transactions: Exploring the Need for Further Reform under the Trade Practices Act" (1994) 22 ABLR 323; Zumbo F, "Unconscionability within a Commercial Setting: An Australian Perspective" (1995) 3 TPLJ 183.

arguably redundant in view of s 51AC and, given the parallels between consumers and small business, a compelling case now can be made for rationalising the unconscionable conduct provisions of the *Trade Practices Act* into a single section of general application and doing away with the unconscionable provisions of the ASIC Act.

With these various points in mind, the following provision would be proposed to deal with unconscionable conduct within an Australian Model Fair Trading Law or Code:

> (1) A corporation must not, in trade or commerce, engage in conduct that is, in all the circumstances, unconscionable.
>
> (2) For the purposes of this section, "unconscionable conduct" includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.

This proposed provision has a number of noteworthy features. First, the proposed provision prohibits unconscionable conduct in trade or commerce generally. This removes the current reference to the supply of goods or services in both ss 51AB and 51AC, but is in keeping with the current s 51AA. The current reference to the supply of goods or services in ss 51AB and 51AC is superfluous and its removal would simplify significantly the proposed provision. Importantly, prohibiting unconscionable conduct in trade or commerce generally is intended to create a new ethical norm of conduct in the same way that s 52 has established a norm of conduct within trade or commerce.

Second, the proposed provision incorporates a non-exhaustive definition of unconscionable conduct. This is intended to overcome the restrictive view that the courts are currently taking towards the notion of "unconscionable conduct" under ss 51AB and 51AC. Indeed, in applying the concept of "unconscionable conduct" under ss 51AB and 51AC, the courts are focusing increasingly on procedural unconscionability. In doing so, the courts continue to be influenced by the narrow equitable doctrine of unconscionability. While perhaps not surprising, given that the concept of "unconscionable conduct" has been previously used under the equitable doctrine of unconscionability, this procedural unconscionability focus unfortunately raises considerably the threshold for succeeding under ss 51AB and 51AC. Thus, to ensure that the concept of "unconscionable conduct" in the proposed provision is given a wider application than is currently the case, a legislative definition of the concept of "unconscionable conduct" is proposed. Such a definition defines "unconscionable conduct" by reference to a variety of other known concepts that make it clear that the term "unconscionable" as used under the proposed provision is one concerned with dealing with unethical conduct within trade or commerce generally.

Finally, the proposed provision does not have a monetary cap on the value of transactions covered by the proposed provision. The lack of a monetary cap can readily be supported on the basis that: (a) a monetary cap will exclude some parties from the proposed provision; (b) definitional problems regarding the application of the monetary cap are avoided; and (c) a monetary cap can be very artificial and ultimately detracts from what should be the only issue in cases under the proposed provision; namely, whether or not the conduct is "unconscionable".

THE NEED TO PROMOTE FAIRER CONSUMER CONTRACTS

While more streamlined consumer laws and contracts drafted in plain language would be a major step forward for Australian consumers, they would be insufficient to deal effectively with the ongoing concerns regarding the issue of substantive unconscionability and, in particular, the alleged use of unfair contract terms. Why does this issue arise? Quite simply because of the emergence of pre-prepared or standard form contracts typically offered on a "take it or leave it" basis. The problem is not with standard form contracts in themselves, since they can represent an efficient way of doing business. Rather, it is the way that standard form contracts may be used to shift the risks onto the consumer. Indeed, the greater the inequality of bargaining power between the supplier and the consumer, the greater the temptation of the supplier to use pre-prepared or standard form contracts in a manner that shifts the contractual risks and obligations disproportionately onto the consumer. Thus, suppliers may be tempted to use contract terms that go beyond what is reasonably necessary to protect their legitimate business interests and to do so in a way that gives rise to a significant imbalance between the rights and obligations of the supplier and consumer.

While some may seek to argue that consumers can simply try to renegotiate or walk away from such contracts, such contentions do not reflect the harsh reality that standard form contracts do not easily lend themselves to renegotiation. Not surprisingly, suppliers generally do not provide a ready mechanism for such renegotiation, and the cost of doing so for the supplier and the consumer may outweigh the value of the goods or services involved. Similarly, if consumers walk away, they are likely to find other suppliers relying on similar standard form contracts. In this "take it or leave it" environment, consumers are exposed to the possibility of excessively one-sided contracts in which they may be forced to carry risks over which they have little or no control, or where their rights are severely limited to their detriment. They may also, over the course of the contract, be exposed to a disadvantageous realignment of the contractual risks or obligations as a result of the business' ability to unilaterally vary the contract.

In view of the growing use of standard form contracts offered on a "take it or leave it" basis, it is not surprising that some legislatures have moved to facilitate greater judicial scrutiny of unfair contract terms or "substantive unconscionability". As mentioned above, the United Kingdom[5] and Victoria[6] have enacted legislation for dealing directly with unfair terms in consumer contracts. Both frameworks focus solely on making void or unenforceable unfair terms in consumer contracts and do so by defining unfair terms primarily by reference to the concept of good faith, and a significant imbalance in the contractual rights and obligations of the parties to the detriment of the consumer.[7] Where a term is found to be unfair, both frameworks provide that the term will be unenforceable against the supplier, with the remainder of the contract continuing to bind the parties where it is capable of existing without the unfair term. Significantly, these frameworks provide a more targeted and effective mechanism for dealing directly with unfair terms in consumer contracts than do the equitable doctrine of unconscionability and the existing statutory prohibitions against unconscionable conduct.

While the United Kingdom and Victoria frameworks reflect a recognition by those legislatures that a significant imbalance of bargaining power between consumers and suppliers may be exploited by the supplier in the drafting of contracts, it is readily apparent that this recognition has also prompted debate as to whether a growing imbalance of bargaining power between small businesses and larger businesses may also lead to the larger businesses drafting contracts to include allegedly unfair terms. This debate has emerged from discussion papers prepared by law reform bodies in Australia and the United Kingdom. In January 2004, the Australian Standing Committee of Officials of Consumer Affairs released a national discussion paper on the issue of unfair contract terms in which it called for comment on the possible inclusion of business-to-business contracts in any legislation dealing with unfair contract terms.[8] Similarly, in 2002, the English Law Commission issued a consultation paper on unfair terms in contracts in which it considered extending the protection against unfair terms to businesses.[9]

Both papers include a number of arguments both for and against including business-to-business contracts involving small businesses within a legislative framework for dealing with unfair contract terms. In doing so, both papers have identified allegedly unfair terms in such contracts as an issue needing to be addressed. Indeed, while both papers acknowledged the commercial character of business-to-business contracts and the possible greater sophistication of small businesses as compared

[5] See the *Unfair Terms in Consumer Contracts Regulations 1999* (UK).

[6] The Victorian legislation is found in Pt 2B of the *Fair Trading Act 1999* (Vic).

[7] See *Unfair Terms in Consumer Contracts Regulations 1999* (UK), reg 5; *Fair Trading Act 1999* (Vic), s 32W.

[8] Australian Standing Committee of Officials of Consumer Affairs (SCOCA), *Unfair Contract Terms Discussion Paper* (2004), http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/CD456F7C38F523684A256E240014EF7C?OpenDocument&L1=Publications viewed November 2007.

[9] The Law Commission (UK), *Unfair terms in contracts: A joint consultation paper*, Consultation Paper No 166 (2002), http://www.lawcom.gov.uk/docs/cp166.pdf viewed November 2007.

to consumers,[10] concern was expressed in them that small businesses in many cases faced comparable imbalances in bargaining power when dealing with larger businesses as those faced by consumers when dealing with suppliers.[11]

Similarly, the authors of both papers also formed the view that the use of standard form contracts offered on a "take it or leave it" basis within a business-to-business context could, as in the case of consumer contracts, possibly lead to the inclusion of potentially unfair terms in contracts between small businesses and larger businesses.[12] For example, the English Law Commission identified that the following contractual terms as potentially going beyond what was reasonably necessary to protect the legitimate interests of the stronger party:

- deposits and forfeiture of money paid clauses;
- high default rates of interest (unless these can be shown to be penalties);
- clauses allowing unilateral variation in price;
- termination clauses allowing one party to terminate in a wider set of circumstances than allowed for the other party;
- unequal notice periods; and
- arbitration and jurisdictional clauses which seek to severely restrict the rights of a party to choose the forum for dispute resolution.[13]

In short, it was recognised in both papers that the potential problems with allegedly unfair terms could, when compared to consumer contracts, be less severe in business-to-business contracts involving small business, such problems could arise and therefore needed to be considered.[14]

In doing so, it must be remembered that consideration of allegedly unfair terms in either consumer contracts or business-to-business contracts involving small businesses is only concerned with the question of whether or not the supplier or larger business has included terms that are not reasonably necessary for the protection of the supplier's or larger business' legitimate interests. Clearly, a supplier or larger business is perfectly entitled to rely on contract terms that are reasonably necessary to protect its legitimate interests. Indeed, both contracting parties should be entitled to include contract terms that are reasonably necessary to protect their respective legitimate interests. Therefore, the issue of fairness involves an objective assessment of particular contract terms. Specifically, fairness is to be tested by an objective standard of whether or not a contract term that places the consumer or small business at a disadvantage is reasonably necessary for the protection of the legitimate interests of the supplier or larger business. In this way, seeking to deal with unfair terms in consumer or small business contracts would in no way detract from, or undermine the ability of a supplier or larger business to include contract terms that are reasonably necessary to protect its legitimate interests.

Overall, therefore, it is readily apparent that there is considerable commonality in the debate surrounding the need to deal with allegedly unfair terms in consumer contracts and the need to do likewise in business-to-business contracts involving small businesses. Indeed, there are growing parallels between consumers and small businesses in their respective relationships with suppliers or large businesses. Such parallels are undoubtedly being accelerated through the increasing use of standard form contracts offered on a "take it or leave it" basis to both consumers and small businesses. In view of such parallels, arguably it would be more efficient to have a single legislative framework for dealing with allegedly unfair terms in contracts involving a significant imbalance in the contractual rights and obligations of the parties. This would avoid repetition and ensure a streamlined approach to unfair contract terms. The following provision would be proposed to deal with unfair contract terms within an Australian Model Fair Trading Law or Code:

[10] See Law Commission, n 9, p 131. See also SCOCA, n 8, p 54.

[11] See Law Commission, n 9, p 131; SCOCA, n 8, p 50.

[12] See Law Commission, n 9, p 130; SCOCA, n 8, p 50.

[13] See Law Commission, n 9, p 126; SCOCA, n 8, p 51.

[14] See Law Commission, n 9, p 131; SCOCA, n 8, p 50.

(1) A corporation must not, in trade or commerce, include in a contract, arrangement or understanding; or proposed contract, arrangement or understanding, an unfair term.
(2) A term is to be regarded as unfair for the purposes of subs (1) if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract, arrangement, or understanding; or the proposed contract, arrangement or understanding to the detriment of the consumer or small business.
(3) An unfair term is void.
(4) A prescribed unfair term is void.
(5) The contract will continue to bind the parties if it is capable of existing without the unfair term or a prescribed unfair term.
(6) For the purposes of this section a "prescribed unfair term" means a term that is prescribed by the regulations to be an unfair term.
(7) This section only applies to a contract, arrangement or understanding; or proposed contract, arrangement or understanding entered, or proposed to be entered into on or after the commencement of this section.
(8) This section does not apply to contract terms that are required or expressly permitted by law, including a prescribed industry code or prescribed industry contract, but only to the extent required or permitted.

This proposed provision is intended to promote judicial scrutiny of unfair contract terms themselves. In doing so, the proposed provision targets a contract term that is "unfair" and, in this regard, the term is defined in the proposed provision in a manner consistent with that term's use in the United Kingdom and Victorian frameworks. Importantly, the concept of "unfair" in relation to contract terms has been judicially considered under both the United Kingdom and Victorian frameworks and, on each occasion, the term has been interpreted appropriately to target terms containing a significant imbalance in the parties' rights and obligations under the contract, and without in any way undermining contractual certainty.[15]

The proposed provision would operate to make the unfair term void, with the remainder of the contract continuing to bind the parties where capable of doing so without the unfair term. Significantly, the proposed provision allows for specific contract terms to be prescribed as unfair, thereby preventing their use in advance, where there is a compelling case that the term causes a significant imbalance in the parties' contractual rights and obligations to the detriment of the weaker party and without any offsetting benefit. Indeed, in assessing whether or not a term is either unfair or should be prescribed as unfair, it is essential that the term in question be assessed by reference to the contract as a whole and having regard to whether any detriment flowing from the particular term is offset in some way by a recognisable and reasonably proportionate benefit in another part of the contract. Thus, the elements in the definition of "unfair" relating to the "requirements of good faith and in all the circumstances" point to a need to make an overall assessment of the contract to determine whether or not the terms of the contract go beyond what is reasonably necessary to protect the legitimate interests of the stronger party.

Significantly, a contract term required or expressly permitted by law, including a prescribed industry code or contract, is excluded from the operation of the proposed provision. This provides sufficient scope for an industry and those involved in, or affected by, the particular industry to work towards the development of an industry code or contract that sets out "fair" contract term(s) vetted and approved by the relevant Minister on the advice of the regulatory agency administering the Model Fair Trading Law or Code.

Finally, the question arises as to who may enforce the proposed unfair contract term provision. In this regard, there are a number of possibilities, including allowing only the regulatory agency to enforce the regime, extending the ability to enforce the regime to prescribed consumer and other representative groups, or providing for a private right of action. In the interests of maximising access to justice and facilitating self-help, it would be appropriate to provide for all these possibilities in

[15] See *Director General of Fair Trading v First National Bank* [2001] UKHL 52; *Director of Consumer Affairs v AAPT Ltd* [2006] VCAT 1493.

relation to the proposed provision. A private right of action is available under the Victorian framework and this has allowed affected consumers access to justice without in any way opening the floodgates or undermining contractual certainty.

REGULATORY AGENCIES AND "CLASS COMPENSATION" ORDERS

While the drafting of laws in plain language and the streamlining of laws would promote a greater understanding of those laws, their effectiveness can be undermined if it is time-consuming or expensive to recover losses from breaches of the Model Law or Code. All too often, the ACCC can successfully prosecute breaches of the *Trade Practices Act*, but those affected by the conduct find it difficult to cost-effectively recover their losses. Within this context, it is appropriate to consider a new approach to efficiently and effectively facilitating the recovery of losses from breaches of the *Trade Practices Act* or a future Model Fair Trading Law or Code. Such an approach could involve giving a court the power to make a "class compensation" order, whereby the court would, following a finding that there has been a breach of the *Trade Practices Act* or Model Law or Code, order the contravening party or parties to compensate all affected parties who notify a court-appointed assessor of their loss or other claim within a specified period of time.

Under a class compensation order, a court would have the power to compensate affected parties without the need for those parties to bring their own actions or recovery proceedings. In particular, a class compensation order would, once a breach has been found in an action brought by the regulatory agency, allow the court itself to set up a framework:

(a) to ensure that affected parties are notified within a reasonable period of time that they are able to make a claim to the particular court in relation to the contravening conduct;
(b) allowing a reasonable period of time for affected parties to lodge their claims;
(c) appointing an assessor, answerable to the court, to review all claims lodged by affected parties within the specified time; and
(d) for the court to finally approve any claim recommended by the assessor.

This process would be funded by the contravening party or parties, and would provide a streamlined process for dealing with individual claims arising from a proven breach. While there would be judicial oversight of the process, the court itself would not be tied down by having to consider the factual background of each affected party. Indeed, any factual assessment of individual claims could easily be undertaken by an assessor or assessors, who could conduct such assessments in a very efficient and cost-effective manner without the need to take up valuable court time.

Thus, a class compensation order would not only enable parties affected by the contravening conduct to recover their losses in a streamlined manner, but such an order would be an excellent way to avoid courts being clogged up by a proliferation of individual recovery actions which may occur at present. Importantly, a class compensation order would allow the courts to respond flexibly and effectively to cases where a large number of parties is affected by the contravening conduct and, in this regard, the availability of a class compensation order would enable the regulatory agency to play a leadership role in targeting conduct that has a wide-ranging detrimental impact on consumers and other similarly affected parties.

EXPLORING ADDITIONAL MECHANISMS FOR BETTER DIRECTLY EMPOWERING CONSUMERS

While, clearly, regulatory agencies have a critical leadership role to play in enforcing a Model Fair Trading Law or Code and in helping affected parties to recover losses in an efficient and cost-effective manner, it is clear that regulatory agencies simply would not have the resources to pursue all breaches of the *Trade Practices Act* or future Model Law or Code. In such circumstances, it is essential that consumers and similarly affected parties are allowed access to low-cost and user-friendly binding dispute resolution processes. This could include (a) the establishment of industry ombudsman schemes under which binding determinations could be made following the failure of mediation or other non-binding processes, and (b) providing greater access to the Federal Magistrates Court.

Providing access to the Federal Magistrates Court in relation to breaches of Pt IV of the Trade Practices Act

While consumers and other affected private parties currently are able to bring their own legal proceedings in the Federal Court in relation to breaches of Pt IV of the *Trade Practices Act* or to recover any loss or damage from such breaches, these Federal Court actions can be very expensive to run. In this regard, consumers and other affected parties could be allowed to: (a) bring their own proceedings for breaches of Pt IV in the Federal Magistrate Court, and (b) rely on s 83 findings of fact from a successful ACCC prosecution to commence actions in the Federal Magistrates Court to recover any losses arising from breaches of Pt IV. This would be consistent with what already occurs in relation to other breaches of the *Trade Practices Act*.

Allowing such access to the Federal Magistrates Court in relation to breaches of Pt IV would empower these parties to recover those losses in a timely and cost-effective manner, in contrast to applying to the Federal Court or relying on the ACCC to bring representative actions. This would be consistent with consumers and other affected parties already having access to the Federal Magistrates Court in relation to other parts of the *Trade Practices Act*. It would promote self-help and self-empowerment in a cost-effective manner, and is ultimately preferable to a situation where parties are left to run expensive litigation in the Federal Court or rely on a public agency like the ACCC with scarce public funds to try and recover private losses. Importantly, allowing access to the Federal Magistrates Court to consumers and affected parties for breaches of Pt IV would require only that reference to "Pt IV" be inserted in s 86(1A) of the *Trade Practices Act*.

CONCLUSION

In reviewing key areas of Australia's consumer protection laws, it has become readily apparent that a number of initiatives could easily be implemented to improve the efficiency and effectiveness of such laws. Such initiatives range from drafting consumer laws and contracts in plain language through to facilitating greater access to justice and providing for mechanisms to allow classes of affected parties to recover losses in a timely and cost-efficient manner. Implicit in any consideration of these initiatives is a realisation that there are growing parallels between consumers and other parties such as small businesses in terms of how they are allegedly dealt with by larger parties. Indeed, in relation to both procedural and substantive unconscionability, consumers and small businesses face the same types of allegedly unethical conduct by larger parties and, accordingly, they both need access to the same legislative provisions allowing for judicial scrutiny of any alleged unconscionability. Importantly, recognising the parallels between consumers and other similarly affected groups such as small businesses can assist in streamlining legislative provisions by having one set of laws of general application rather than a confusing proliferation of legislative provisions as is currently the case, with the various provisions dealing with unconscionable conduct. Importantly, a streamlining of legislative provisions to remove repetition or redundant sections would greatly assist consumers and other similarly affected parties by facilitating a better understanding of such laws and, in turn, promoting a greater level of compliance with the laws. Such benefits could then quite easily be maximised through the development and implementation of a "best practice" Australian Model Fair Trading Law or Code to replace the current multitude of, at times, inconsistent and repetitive consumer protection laws.

