20th July 2008 Scott Cooper

The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100 Parliament House
Canberra ACT 2600

**Re: Inquiry into Franchising Code of Conduct**

Please accept this as a submission for consideration in your inquiry into franchising.

In short, I was a franchisee within the [redacted], which is one of the largest franchising systems in Australia, for a period of around eighteen (18) months. In that short time I unsuccessfully attempted to address a problem of an agreed breach in mandatory disclosure requirements within the Disclosure Document presented to me. After addressing the issue directly and subsequently through mediation and costly continued legal effort, the only constant was the franchisors combined refusal to negotiate and their insistence that I continue paying fees or the business would be terminated.

This occurred despite the other people listed in the contract agreeing by fact that the Disclosure Document presented to me was not in strict accordance with the mandatory requirements of the Franchising Code of Conduct. There was also an admission I was entitled to a remedy. The true problem arose though, when the other listed people denied all liability based on their not being involved in the preparation of the Disclosure Document?

Apart from a token settlement offer that was claimed to have been made in the financial interests of the franchisor and the franchisee, the only true effort to "fairly" resolve the dispute was an aggressive invitation to take the matter to court and determine liability. Recognition of the fact that the costs of litigation are incredibly high and prohibitive on both a personal and financial front, in practice it was not even a consideration, so to mitigate my financial and personal damage, I terminated the franchise agreement in May 2008.

With this recent experience, I have been exposed to many of the issues you are seeking to address in the course of your inquiry, and I would like to offer a more detailed submission, which is attached. If you require any further details or information please do not hesitate in contacting me. I would welcome any opportunity to assist the inquiry in any manner deemed appropriate.

Regards

Scott Cooper

(Scott Cooper)

## Submission for Inquiry into Franchising Code of Conduct

### Introduction

As noted in the background notes for your ***"Inquiry into the Franchising Code of Conduct[1]"*** the legal landscape of franchising in Australia is going to be clarified and quite possibly altered in a dramatic way in the not too distant future with the handing down of the High Court's decision in the ***Master Education Services Pty Limited –v- Ketchell*** appeal. In relation to "the Code", what weight do the words "mandatory", "must" and "must not" truly carry? Unless I am mistaken, this is one of the key issues before the Justices of the High Court.

Whilst the legal debate has reached the peak of the legal mountain in Australia, it should not be forgotten that common sense and "fairness" must still be a significant consideration in any debate for potential changes to the law. It has to be stated I have no legal qualifications, but have done some relevant research and have found it appears from a legal standpoint, the Justices of the High Court are more than likely going to uphold the ***"Ketchell"*** appeal, and determine that a breach of the Code is a breach of the Act, and accordingly should be dealt with under the provisions of the Act, despite some 'sympathy' for the wording and indeed implications for the intended protection of franchisees.

To quote His Honour Justice Kirby,
***"...you do not have to be too knowledgeable about the affairs of the world to know that franchise agreements can be very oppressive to vulnerable people. They go in starry eyed thinking they are going to end up like McDonald's and they come out at the other end short of a lot of money."***

Irrespective of the High Court decision, the one thing that stands above all else that needs to be emphasised in relation to Franchising in Australia, is that the existing laws and regulatory provisions in place to protect franchisees are entirely out of reach for the vast majority of franchisees due to cost. The law is only truly enforceable before a court, and the cost of engaging the legal system is undeniably an extreme deterrent, and must also be a considerable constraint on the ACCC in any consideration of complaints and possible action. Costs were in fact a significant consideration in the High Court granting Special Leave to Appeal the decision in ***Ketchell –v- Master of Education Services Pty Ltd [2007] NSWCA 161***[2]. The granting of Special Leave to Appeal was on the condition of an undertaking by the franchisor to also cover the costs of the franchisee, regardless of the outcome[3].

---

1. http://www.aph.gov.au/senate/committee/corporations_ctte/franchising/franchising_background.pdf

2. http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/nsw/NSWCA/2007/161.html?query=Ketchell%20v%20Master%20Education%20Services%20Pty%20Ltd

*3. High Court of Australia transcript* ***Master Education Services Pty Limited v Ketchell [2008] HCATrans 89 (8 February 2008)***
http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/HCATrans/2008/89.html?query=ketchell

With significant costs at all levels of enforcement, it is clearly not feasible for the ACCC to act on all complaints alleging breaches of the Code and/or Act, so it seems their initial attention lies on the franchisors intent to follow "the Code". This has the unfortunate consequence though of allowing franchisors room to move with the defence of a "procedural" or "technical" breach, so long as it is not too "widespread"

or "significant"? But what is "widespread", and what is "significant"? In the extreme cases that the ACCC has acted, it has to be acknowledged that the ACCC has been extremely effective, but unfortunately by sheer weight of numbers, too many franchisees in dispute are left at the mercy of the franchisor. Franchisees are unable to obtain any relief or remedy from the legal system because they simply cannot afford it, and franchisors know it.

In my brief and unfortunate experience in franchising, I would summarise it as an exercise in mislaid trust and a stark exposure of my commercial naivety. Franchising to me is little more than an entangled web of deceit and dishonesty, and in what appears to be an all too common occurrence, franchisees are too readily placed in an extremely vulnerable position once they enter a Franchise Agreement under a hardened and well practiced franchisor.

To quote [redacted] (the name and face behind one of Australia's largest franchise systems the [redacted]);

***"Franchisors also have to give you a Disclosure Document with the Contract, which can be useful. Apart from this, protection for Franchisees is pathetically weak."***[4]

Personally, I attempted to address several issues, including but not limited to a breach of the Franchising Code of Conduct. Specifically, the breach was an agreed failure of the franchisor to provide me with a Disclosure Document in strict accordance with the mandatory requirements of the Franchising Code of Conduct.

As a result of the franchisors debate and overall denial of any liability, coupled with their subsequent failure to enter any form of negotiation, at considerable cost a lawyer was engaged. Despite mediation and further attempts to resolve the issue, all was to no avail without proceeding with the franchisors "invited" litigation to determine liability. This was not, and is not an option given the immense costs involved. It was a financial struggle for me to even pay the legal bills that saw me to this "dead end", so to mitigate both financial and personal damage I terminated the Agreement myself, and walked away from the franchise with nothing.

When one looks at a franchise system, it is undeniable that a franchisor has considerable advantage in relation to both influence and knowledge of the franchised business. The knowledge of the business is crucial to any franchisee making an informed decision when considering entry into a franchise agreement or even renewing an agreement. Accordingly, the mandatory disclosure requirements listed in the Franchising Code of Conduct must be fully and totally enforceable under the law, and not just by those who choose to comply. It should not be possible for a franchisor to adopt a selective disclosure policy, and only disclose information that will assist their selling of a franchise. What does the word "mandatory" truly mean, if franchisors can adopt selective disclosure without any real fear of reprisal?

---

4. http://blogs.theage.com.au/enterprise/archives/2007/03/perils_and_plea.html

More accountability on the part of the franchisor needs to be addressed in relation to disclosure before a Franchise Agreement is entered into or renewed, because afterwards is simply too late. The franchisee is in reality trapped and very easily rendered powerless once the Agreement is signed.

Some questions spring to mind in light of my experiences that will hopefully be addressed by this inquiry?

- The Franchising Code of Conduct is clear in its intent and clear in its reading, but to what extent is it enforced?

- What are the real implications to a franchisor for a breach of the Franchising Code?

- Does the Franchising Code of Conduct in its current form provide adequate protection or indeed options for franchisees in dispute with a franchisor?

- Costs of engaging the legal system are incredibly high on many fronts, and a considerable deterrent for the vast majority of franchisees.

  How can dispute resolution provisions be improved to level the playing field, or alternatively how can the legal system become more accessible to distressed franchisees?

- How many people have walked away from a franchise after falling victim to a ruthless franchisor, due to a lack of resources to bring about an enforcement of the Franchising Code of Conduct?

There are many questions that could be asked, but with my limited experience in both law and franchising, there is little that I can offer in the way of answers. For now I would like to outline some thoughts under the following headings that may assist in finding solutions;

- Franchising Code of Conduct
- Disclosure
- Dispute Resolution Provisions under Part 4 of the Code
- Alternative Dispute Resolution Provisions
- "Good Faith"
- Australian Consumer and Competition Commission
- Franchisor Contractual Liability
- Conclusion

## Franchising Code of Conduct

Whilst it is accepted that the Franchising Code of Conduct is indeed law and falls under Section 51AE the Trade Practices Act 1974 as a 'mandatory code', in reality the Franchising Code of Conduct is not able to be enforced to any large extent on franchisors, unless franchisees have sufficient funds to litigate.

Franchisors if inclined are able to run the gauntlet to maximise franchise sales without any real fear of reprisal from either the ACCC or the legal system.

Lawyers even go as far as to offer advice suggesting a degree of protection to franchisors for breaches of the "mandatory" Franchising Code of Conduct. To provide some examples of such advice found on websites

**Mason Sier Turnbull...**

***"Until the decision in the Ketchell case it was often thought that the consequences for non-compliance with the Franchising Code were minimal. Although non-compliance constitutes a breach of the Trade Practices Act, in most cases such non-compliance would not be the cause of any loss, and usually, disgruntled franchisees would have other more solid bases upon which to make claims against a franchisor."*** [5]

**Deacons...**

***"It was previously thought that breach of the Code did not automatically invalidate the franchise agreement with a court having discretion under the Trade Practices Act to do so, to award damages, or to make such other orders as the court saw fit."*** [6]

**Cutler Hughes Harris....**

***"...franchisors may wish to write to the ACCC and to the Minister for Small Business asking for the Code to be changed. The change required is a statement to the effect that non-compliance with the Code does not render a franchise agreement void for illegality"*** [7]

The overall theme is that if a franchisor is alleged to be in breach of the Code or indeed the Act, regardless of the "mischief", the franchisee has a means of having the matter dealt with in the courts via the smorgasbord of remedies available under the Trade Practices Act. In essence there are no automatic consequences for a breach of the Code, let alone any penalty?

The gaping void created here is the undeniable fact that the legal system is out of reach for the vast majority of franchisees. Most franchisees are not adequately resourced personally, emotionally or financially to confront a well financed and well practiced franchisor by engaging the legal system. Even if the franchisor is knowingly in breach of the Code and/or the Act, and the franchisee is able to engage the legal system, the cards are already heavily stacked in favour of the franchisor, with lawyers on staff and very predictable stalling tactics ultimately taking a considerable financial toll. All too common with the law, it is not the person with the strongest case that succeeds in litigation, but the person with the deepest pockets.

---

5 http://www.mst.com.au/?id=228

6 http://www.deacons.com.au/UploadedContent/NewsPDFs/ff_019_0807.html

7 http://www.cutlers.com.au/resources_detail.cfm?id=131006599

This perceived "protection" for franchisors where a breach of the Code in itself being of little consequence was brought under threat by the ***"Ketchell"***[8] decision, where the New South Wales Supreme Court – Court of Appeal, ruled that a Franchise Agreement was void on the grounds of illegality for breach of the disclosure requirements of the Code.

His Honour President Mason stated in handing down the unanimous decision in the "Ketchell" Case

***"The respondent next submits that the appellant's analysis brings down contracts for breach of the Code irrespective of whether the breach is substantial or merely minor, technical or procedural. This is an argument that needs to be taken up with the Parliament. One frequently encounters provisions that relieve against strict compliance (see eg s172(3) in relation to prescribed forms and notices). But s51AD and cl 11 of the Code are not qualified in this way. Nor does the Act enable the defaulting franchisor to point to the opportunities availed of by the franchisee to rely on her own specialist's advice. [Paragraph 43]***

***"In any event, I do not view the franchisor's breach of cl 11 as inconsequential. The disclosure requirements of the Code were clearly enacted for the protection of prospective licensees..." [Paragraph 44]***

One of the primary concerns for franchisors and indeed the Franchising Council of Australia (FCA) surrounding this decision was the heavy handedness of such a decision, and the implications for the franchising sector as a whole. Terms such as "sledgehammer" and "blunderbuss" have been used to describe the decision, but is it any less damaging than the effect of a termination and/or financial ruin suffered at the hands of ruthless franchisors?

In his findings in the ***"Hoy Mobile Pty Ltd –v- Allphones Retail Pty Limited"***[9], His Honour Justice Rares expressed concerns towards the implications of the ***"Ketchell"*** decision, stating amongst other things,

***"...there would be commercial havoc where franchisors had perhaps innocently and inadvertently failed to do everything that was required by the Code." [Paragraph 99]***

Commercial havoc is the very thing that can be, and too often is experienced by franchisees as a consequence of the franchisors failure to comply with the Code.

Justice Rares acknowledged the importance of the Code in the protection of franchisees, ***"A principal purpose of the Code is to protect franchisees" [paragraph 98]***, but then suggested ***"non-compliance with the Code was not intended to avoid the contract, but rather to give rise to rights under the Act to have the contract varied or made void so as to remedy the consequence of a non-compliance with the Code" [paragraph 105]***

---

8 *Ketchell –v- Master Education Services Pty ltd [2007] NSWCA 161*

9 *Hoy Mobile Pty Ltd –v- Allphones Retail Pty Limited [2008] FCA 810*

On the surface it appears that both decisions acknowledge the importance of the Code as a protection for franchisees, and that non compliance can indeed have the consequence of the Agreement being rendered void. The essential difference lies where President Mason suggests it is an automatic consequence, but Justice Rares suggests it is an option available through the courts via the smorgasbord of remedies detailed under Section 87 of the Act.

Again may I ask, where does a distressed franchisee obtain the funds required to pursue the legal action required in order to gain such relief?

With such legal "confusion" surrounding "the Code" at present, ultimately resulting in clarification being sort via the High Court, how can a franchisee be expected to accurately certify their reading and understanding of "the Code"? Much of the legal debate surrounding the ***"Ketchell"*** case has centred on the specific wording, or intent of the Code? What was the Parliaments intent in enacting the code?

It was indisputably enacted for the protection of participants in the franchising sector - primarily franchisees. When looking at Clause 10 of the Code under ***"Franchisor obligations"*** it reads, ***"A franchisor must..."*** With use of the words ***"must"*** and ***"must not"***, did parliament intend for a breach of "the Code" to have consequences in itself, or was it intended to fit within the scope of the costly remedies available under the Trade Practices Act?

At great peril, franchisees place a deal of reliance on "the Code", but it undeniably means very little unless they have vast sums of money to tread the dangerous path of litigation. What we have in place is a considerable structural protection for franchisors, by way of franchisees having to struggle with immense financial hurdles to obtain protection or gain remedy, when they are already more than likely suffering financial distress.

To quote Peter Switzer from an article in *"The Australian"* on 10 June 2008 *"Ketchell franchise decision faces High Court test"*

***"The irony of all of this legal mumbo jumbo is that many franchisors have hidden behind the strict letter of the law to take too many franchisees to the proverbial cleaners after the franchisors have behaved badly. At the end of the day, a sensible person has to hope that the law does not end up looking like an ass."*** [10]

With such focus on the cost of litigation and the true understanding of the Code, it would be remiss not to mention the championing of the ***"Ketchell"*** High Court Appeal by the Franchising Council of Australia (FCA), and perfectly fair to question their motive.

---

*10* http://www.theaustralian.news.com.au/story/0,25197,23837915-17164,00.html

At considerable cost to the FCA, this appeal was brought before the High Court over a decision that undeniably has dramatic implications for the franchise industry in relation to the Code. Have they as the "franchise sector representative" ever assisted a franchisee with actions towards a franchisor to "clarify the Code" and protect the industry? I feel it more than reasonable to suggest that the only reason this action was taken by the FCA was directly related to the legal threat the "Ketchell" decision posed to the distinct advantage that franchisors currently have. To quote Stephen Giles in an article written for *"Lawyers Weekly Online"* entitled *"Is Ketchell a catch-all?"*[11]

***"Prior to the decision, it had been assumed that a breach of the Franchising Code of Conduct ("the Code") had no automatic consequences"*** suggesting that the NSW Court of Appeal ***"put the cat amongst the pigeons when it handed down its decision"***

The FCA provided considerable assistance and support to the franchisor in the Application for Special Leave to Appeal, but the surprising sting in the tail handed down from the High Court was that the appeal would only be heard on the condition that the franchisor would also cover the costs of the franchisee regardless of the decision. Funding support for the franchisee was not a consideration until the High Court insisted on it being, contrary to the claims of the FCA that they were not taking sides.

To quote Steve Wright from an article on the *"Franchise New Zealand"* website entitled *"FCA to fund Ketchell appeal"*

***"The FCA is careful to emphasise that it has not taken a decision to support a franchisor against a franchisee."..." We will be covering the costs of both the franchisor and the franchisee in the High Court so we are genuinely tackling the issue, not supporting one side or the other."***[12]

May I put it to you, that with so much to play for, the FCA was forced into covering the costs of the franchisee so their (the FCA) appeal could proceed.

If as the FCA claims, they represent the sector as a whole, is it not a good thing for the franchising industry that a decision was handed down that levels the playing field by giving "bite" to the Code and giving force to words such as "mandatory", "must" and "must not" in relation to the entry conditions of a Franchise Agreement?

Doesn't this provide added protection for participants of the sector as a whole, or are the current imbalances preferred, whereby the Code is a "best practice" principle, and if there happens to be a problem, the franchisor is safe knowing the franchisee is forced to take the matter to court?

To again quote Stephen Giles from the *"Is Ketchell a catch-all?"* article

***"The Code was enacted pursuant to the TPA and was intended to be the first of many industry codes providing a more flexible regulatory mechanism for industry issues."***

---

11 http://www.lawyersweekly.com.au/articles/Is-Ketchell-a-catch-all_z200229.htm

12 http://www.franchise.co.nz/article/view/593

If the Franchising Code of Conduct is mandatory, where does the word flexible come into play? Mandatory and flexible are words that do not seem to sit well together in relation to the law.

With the self proclamation of the FCA being the industry 'peak body', yet demonstrating a clear bias towards franchisors, further supported by their representation on the ACCC Franchising Consultative Committee, what hope is there for franchisees to even get consideration for a more balanced approach in franchising? The FCA does not want balance, it wants control. It is more than reasonable to suggest that on past performance, it is obvious that the FCA sees the best way to protect the franchise industry is by throwing full support behind the franchisor. "Loose" laws and flexibility are far more conducive to industry growth!!

From page 31 of the FCA submission to the South Australian Franchising Inquiry

***"The predecessor body to the FCA, the Franchisors Association of Australia, was fundamentally a franchisor networking group, and was described in Federal Parliament as unrepresentative and "controlled by a small cabal of franchisors"."***

Has anything really changed? If the FCA supports the Code, and the Code is indeed mandatory, why are they so keen to fight more serious implications or consequences for a breach of the Code?

"Honesty" and full compliance must be too much of a threat for the expansion of the franchising industry? With so much to gain, why can't franchisors be made to comply more stringently with a "mandatory" code?

## Disclosure

The centre piece of my dispute was an agreed fact that I was not supplied with a Disclosure Document in full accordance with the mandatory requirements of the Franchising Code of Conduct.

When referring to Part 2 of the Franchising Code of Conduct (Disclosure), it is clear on reading that the onus and indeed obligation lies squarely upon the franchisor to ensure that before entering any Agreement and receiving any non-refundable monies from the Franchise Agreement, they must provide a Disclosure Document in strict accordance with the mandatory requirements.

To quote the Franchising Council of Australia from their submission put before the South Australian Franchise Inquiry[13] (page 9)

***"Australia has the most comprehensive franchise regulatory framework in the world. The cornerstones of that framework are:-***

> ***(1) The Franchising Code of Conduct requirement to provide a detailed disclosure document to prospective franchisees prior to signing a franchise agreement. In addition to typical requirements to disclose the franchisor's business background, relevant financial information, previous litigation and solvency history and other relevant matters the Code uniquely requires the franchisor to:***
>
> > ***(a) include a list and contact details of existing franchisees, which facilitates contact with those parties as part of due diligence. As of March 1, 2008 franchisors will also have to disclose details of former franchisees, giving a potential franchisee even greater ability to conduct proper due diligence;***

Additionally on page 10;

***"The information to be disclosed includes a list with contact details of existing franchisees, which enables a prospective franchisee to make contact with those actually involved in the business to verify any information provided by the franchisor."***

A list of existing franchisees and their contact details was not provided to me. This coupled with the franchisors failure to disclose profitability concerns already being addressed by two (2) of the three (3) existing franchisees in the region at the time of my entering the Agreement, it stands to reason that any true ability for me to make an informed decision about the business was greatly reduced.

My real concern was the omission of the mandatory information in my Disclosure Document has never been denied, indeed it was admitted. It is the liability for the omissions that is questioned and strongly denied. It was, and is still claimed, that the document was prepared by a third party, and that the omissions are their responsibility? All in all, the dispute was dismissed as a "clerical error", fitting under the umbrella of a technical or procedural breach. It should also be stated that it was not a one off, with the same omissions made in another agreement at or around the same time. That Agreement has also been terminated by the franchisee to mitigate financial and personal damage, needless to say to the franchisors financial gain.

---

13 http://www.parliament.sa.gov.au/NR/rdonlyres/DC0595AF-761F-4983-B9A5-62F2FBAA867A/10893/FCASubmission21Jan08.pdf

As it stands, the 'honesty' and 'trust' of the franchisor is largely being relied upon in relation to disclosure, which in essence is only "best practice" or a self regulating provision.

- If a Disclosure Document provided before entry is not in accordance with mandatory requirements, what are real implications for a franchisor?

- Is it appropriate to withhold information that is crucial for an informed decision in light of other positive assertions made in the negotiation process?

- If the franchisor is aware of aspects of the business that are inaccurately reflected in literature or even within the contract, is it still appropriate to use this information to induce the sale of franchises?

Where does the term "in good faith" fit into this equation, whether specified or implied?

How many existing Franchise Agreements could be brought into question if the Ketchell decision were to stand, and more alarmingly, how many franchisees have lost everything because they simply didn't have the money to fight, and the franchisor made a "procedural" or "technical error"?

As a guide to the answer of how many agreements could be impacted by the "Ketchell" decision, another quote from Stephen Giles from the *"Is Ketchell a catch-all?"* article

***"The decision sent shockwaves through the franchising industry. With some 50,000 franchise agreements in existence, the FCA estimated that about 10 per cent - or 5000 agreements - could be affected."***

If as it is being suggested that there are 10% or 5000 agreements affected, it follows that there are 10% or 5000 agreements containing technical or procedural breaches in relation to the disclosure requirements of a mandatory code. What is the impact on franchisees?

It is certain that some of these franchisees, and even perhaps most of these franchisees, are perfectly happy with their situation and would not wish to raise the issue with their franchisor, but what about the franchisees that do have an issue?

The predictable response from franchisors and the FCA is that a franchisee is able to seek relief or remedy in court. That is if the franchisee can afford it, and that is a very big "if"! It becomes wretchedly ironic that the laws that were supposedly put in place to protect the franchisees are actually inaccessible?

Concerns exist amongst the franchisor community and the FCA for "aggrieved" franchisees leveraging off the ***"Ketchell"*** decision for commercial gain? Why not? If a franchisee has been wronged and is in financial distress as a consequence of the franchisors failure to comply with the "mandatory" requirements of the Code, does it not follow that the franchisor has benefitted commercially from the breach?

Never the less, franchisors have little to fear because in practice the existing laws create such a significant financial barrier, that they are in fact a very effective protection for the franchisor.

## Dispute Resolution Provisions under part 4 of the Code

If we look at the remedies available to a franchisee in dispute with a franchisor under Part 4 of the Code, the Franchising Code of Conduct suggests referral to mediation. Whichever way one looks at it, dispute resolution under current provisions is grossly inadequate for franchisees. Franchisees become little more than "cannon fodder" if the franchisor is so inclined, or well practiced!

Whilst mediation is often reported as being a more cost effective and arguably a successful means of alternative dispute resolution, it can only be as effective as the respective parties allow it to be. For most franchisees it is the only possible means of being heard when consideration is given to the cost of lawyers and litigation. For many, the thousands of dollars ultimately required to enter mediation in itself, is too much of a burden.

Mediation may well be effective as a means to resolve a difference of opinion in matters like a disagreement over the allocation of marketing and/or advertising funds, or levels of support and communication with the franchisor, but is it appropriate for a matter that centres on a point of law?

The more blatant an issue becomes, the more likely it is that the franchisee will be "battered into submission". Is it even within reason to expect a franchisor that is well aware they are in breach of the Code and/or Trade Practices Act, to enter any "compulsory" mediation with any real intent to resolve the situation, let alone negotiate? That is to say, is it reasonable to expect a franchisor to admit they are in the wrong and just refund all monies paid with damages for their breaches?

In practice, it seems to me that mediation only provides the franchisor with another opportunity to flex their muscles and assert dominance under the additional protection of a shield of confidentiality. The franchisor is able to just point the finger at the franchisee for inadequate due diligence, ineffective marketing, being a bad operator, a negative influence etc, whilst retaining full control of the proceedings. The franchisor may throw a token offer on the table that will at best only cover a small portion of the total monies paid, that will almost certainly be accompanied by the all too familiar confidentiality clause and denial of any or further liability. This is all seen as protecting their business name and financial interests, and from my experience, it is apparently perfectly acceptable in the circumstance?

In my case, a formal dispute was raised following an admission that the franchisor had indeed breached the Franchising Code of Conduct, and that I was indeed entitled to remedy. It was at this point the whole landscape changed dramatically and the heavy artillery was wheeled in.

At the outset of my dispute it was stated that I "had a good case for a refund" and that there was indeed a "breach of the code and should be remedied", but other parties to the Agreement debated liability and all then simply denied any liability. This coupled with a predictable claim that nobody could afford a settlement, saw a "forced" settlement offer extended that was claimed to be for the protection the financial interests of both the franchisor and franchisee. It is indeed a solid defence to say that a remedy is indeed warranted, but then deny all liability and force the franchisee to seek "fair" remedy through litigation and determination of liability. When all was said and done, for me to litigate and determine liability, it would have cost considerably more than any damages that may be claimed and in turn awarded. It has been explained, and I now clearly understand that under the circumstances,

this is seen as protecting ones financial interests? This is a very bitter pill to swallow, given the franchisor has profited from an agreed breach of what is termed a 'mandatory' code!!!

This clearly demonstrates where a gigantic void exists in the current system. The only avenue open for the franchisee to obtain "fair" remedy is litigation, which can be aggressively invited by the franchisor, perfectly safe in the knowledge that in all probability litigation will never eventuate. Personally I was reminded none too subtly both verbally and via e-mail of "the tens of thousands of dollars in legal fees to get more", and accompanying declarations of "deep pockets" etc, so "see sense and accept the offer". As it turns out, even if the settlement offer had been accepted, I would never have received any money given the terms of the settlement and the state of the franchise system as whole. I was even declared "foolish" for not accepting the offer? Was it foolish to reject an offer that I was unlikely to receive any money from, and in the clarity of hindsight, would by fact never have received any money from?

Even with a lawyer engaged to assist the franchisee, the lawyer is largely a dog without bite unless they are able to commence litigation. If the franchisor is so inclined, they simply disregard correspondence and ignore all attempts at further resolution, knowing more money is being "absorbed" from the franchisee via their lawyer. There is little cost associated for the franchisor with their own lawyers on staff, so again, what is really at risk for the franchisor?

To quote the Franchising Council of Australia from their submission to the South Australian inquiry,

***"The Code and the TPA provide comprehensive legal protection from all forms of misrepresentation or illegal behaviour. Any franchisee that has been misled will have a clear legal remedy under existing law, either as a result of a breach of the comprehensive disclosure requirements of the Code or pursuant to the prohibition on misleading or deceptive conduct contained in s52 of the Trade Practices Act. Furthermore the ACCC investigates any complaint alleging breach of the TPA, and actively pursues any franchisor it considers has engaged in unlawful conduct."[Page 11]***

The legal system may well in theory protect franchisees, but the franchisor has a distinct advantage over a franchisee when it comes to legal matters. In reality the vast majority of franchisees are offered no protection at all due to their inability to meet the substantial costs associated with engaging the legal system. In a strange twist of fate, after already losing a considerable sum of money to a franchisor that may be in breach of "the Code" or "the Act", the franchisee is confronted with the immense cost of litigation to prove their damages. May it be strongly suggested that the true damage on many levels has already been done, and the franchisor has won?

Litigation serves little more than to put people at more financial risk, and further aggravate the damages. Legal advice offered to me suggested that once you've been bitten by a snake, only chase the snake if you are sure the venom will not do you more damage. It was explained that the costs of me running the case would exceed any possible claim for damages! Yet again - the franchisor wins!

The problems associated with engaging the legal system was raised by His Honour Justice Kirby in the "Ketchell Appeal"

To quote Justice Kirby,

***"The so-called sophisticated provisions of the Act have an air of unreality, with respect, so far as ordinary consumers and franchisees are concerned because they are not going to rush off and get an injunction in the Federal Court or some other court when the whole point is they have not been given the notice of their entitlements so they are not going to rush off and get sophisticated remedies.***

Justice Kirby goes further late in the transcript to acknowledge the cost of running an action in the Federal Court in response to the remedies available to a franchisee,

***"Yes, but the Federal Court is quite expensive..."***

In what I would describe as perhaps the most distressing or crippling blow in the course of my unfortunate experience, was to be told that even though I had asked all the right questions before entry, I was not persistent or aggressive enough to be deserving of the correct answers. It was explained in no uncertain terms that questioning the answers after entry into the Agreement was too late - they already had my money. Is this successful franchising? Apparently so!

As disturbing as it was (and still is), the most annoying aspect here is that due to these comments being verbal, they cannot be proven, and franchisors know it. Denial at all levels is their preferred weapon of choice. There was repeated denial of many aspects relating to the business. When I was in the process of shutting the business down and more franchisees and even franchisors were openly stating their financial distress, some admissions finally surfaced. I must conclude from my experience that constant denial is simply protecting the franchisors business and financial interests?

As a point of interest in relation to the remedies available to franchisees, under Canadian Franchising Law, the franchisee has the right to rescind a franchise agreement "without penalty or obligation" if the disclosure document does not strictly comply with all statutory requirements. On rescission, the franchisor is obliged to refund any and all payments made by the franchisee, to buy back all inventory supplies and equipment, and to compensate the franchisee for any losses. Italian Franchising Law also allows for rescission by the franchisee in the event of disclosure not being in accordance with mandatory requirements.

This would seem to me to be a 'fair' and equitable outcome for a franchisors' breach of a mandatory code!!!

## Alternative Dispute Resolution Provisions

Contrary to reports suggesting that levels of dispute remain low in franchising, one could suggest that the inability to afford the cost of even engaging a lawyer sees franchisees surrendering to the pressure of the franchisor and soldiering on. Alternatively, the franchisee accepts total defeat and walks away as opposed to raising a dispute and fruitlessly throwing good money after bad. This assertion would seem to be supported by a recent report from the Office of the Victorian Small Business Commissioner.

The Office of the Victorian Small Business Commissioner has established a low cost mediation service, and as revealed in an article on the "Smart Company" web site entitled "Business prefers mediation to lawyers" by Mike Preston on 2 July 2008[14], the Commissioner Mark Brennan indicated,

***"his office has seen a sharp increase in the number of franchise and business-to-business disputes being brought to it for resolution."***

The Commissioner went on to add, ***"more than 4500 businesses come through its doors over the past five years - and 1200 in the past year - to take advantage of its $195 dispute mediation service."..."The lower costs associated with mediation have also seen a jump in franchisees seeking mediation for disputes"***

Perhaps the most disturbing revelation in the report was the discovery of a franchisor that was resisting the low cost mediation in an attempt to exert financial pressure on seventy (70) franchisees!

***According to Brennan, in one case a franchisor sought to resist attempts to have a dispute dealt with through his office because it wanted to exert financial pressure on the 70 franchisees involved by forcing them to use a more expensive dispute resolution process.***

***"We saw that was happening and successfully asked the Office of the Mediation Adviser (a starting point for dispute resolution under the franchising code) to refer the complaint to us, so we were able to thwart the attempt to put the franchisees under financial pressure," Brennan says.***

If one asks around, I am sure the defence for this attempt to exert financial pressure on franchisees would simply be viewed as the franchisor protecting their business name. It must also be remembered that there is already a clear path for franchisees to follow under the provisions of the Trade Practices Act if they want to remedy the situation – if they can afford it?

**Franchisees desperately need an affordable and more effective means of dispute resolution than the prescribed mediation.**

---

14 http://www.smartcompany.com.au/Free-Articles/The-Briefing/20080702-Business-picks-up-for-court-alternative-.html

## Specific Inclusion of the term "in good faith"

I have no legal background, so concede I only have a limited understanding of the implications of the specific inclusion of the term "in good faith" under the law. I feel it safe to assume though, that words such as "honesty", "fairness" or "integrity" would seem to convey the gist of what "in good faith" incorporates? Surely there is already an implied term of "good faith"? Unless I am mistaken, there is, but we keep coming back to the same point – it is only enforceable before the courts, which is something only a "privileged" few are able to pursue.

My understanding of the reluctance to specifically include the term "in good faith" is due to the subsequent requirement to define it under the law. This in itself becomes a difficult task. This also seems to be the "problem" at the opposite end of the spectrum, in defining unconscionable conduct. How does one define unconscionable conduct unless one looks at the circumstances? That is to say, what one person considers "fair" or "unconscionable" may be vastly different to another person's perspective?

Where my understanding of "in good faith" and "unconscionable conduct" becomes particularly clouded is in the application of another term that regularly seems to raise its head - "protecting business interests"? It seems to me that there is very little difference between "threatening" and "bullying" and protecting ones business interests?

Personally, the questions that come to the fore in relation to "in good faith" include;

- Is it acting "in good faith" to withhold information on matters including but not limited to profitability concerns and available work, that are clearly vital to a franchisee performing 'adequate' due diligence? Or is that considered protecting ones business interests?

- Is a franchisor that agrees they are in breach of the Code and yet fails to engage in negotiation in an effort to resolve the matter acting "in good faith"?

I have been led to believe that this type of conduct along with some "verbal intimidation" is all seen as part of the normal process of commercial negotiation and protection of ones business interests? How naïve of me!!!

Please forgive my apparent misunderstanding of the term "in good faith", but through personal experience I have developed a clear understanding of why franchisors via the FCA would resist the specific inclusion of the term. It again has to be asked, is "honesty" and full compliance with a mandatory Code seen as too much of a handbrake for the expansion of the franchising industry in Australia? May it be suggested that the current "flexibility" that exists for franchisors is the root of many of the problems confronting franchisees, and franchisors do not want it changed!

If it were to be included under the Code, the two (2) obvious areas it would need to be applied would be in pre signature discussions and most definitely in any dispute resolution or mediation.

## Australian Competition and Consumer Commission (ACCC)

To this point, I have not made detailed mention of the ACCC, and would now like to address this issue.

It is accepted that the Trade Practices Act is a significant and integral part of the law in Australia, and the enforcement of the Act on all fronts is a monumental task. With the Franchising Code of Conduct making up only a small part of the Act, and the Franchising Industry contributing significantly to the economy, the question may be raised as to whether the ACCC is adequately resourced to devote the effort required to monitor or enforce Franchising in light of the significant growth that Franchising in Australia has experienced in recent years?

Whilst it is known that the ACCC is vigilant in certain areas of Franchising it is accepted that costs involving investigation, legal fees etc, are always of a concern and that not every complaint or query from aggrieved franchisees can be actioned. Never the less, it remains that franchisors so inclined, are well aware that the ACCC will not take aggressive action unless breaches are numerous or significant, but what is numerous or significant? Franchisees would greatly benefit from further clarification of how severe a situation has to be in relation to breaches of the Franchising Code or the Trade Practices Act by a franchisor, before the assistance of the ACCC can be relied upon with any degree of certainty.

Perhaps more resources could be put in place to introduce measures that can assist franchisees before it is too late. Laws that protect tenants from 'rogue' landlords could be considered as the basis for protective measures for franchisees from 'rogue' franchisors. With so much at stake for many franchisees, urgent intervention or assistance is needed. Three months, six months or twelve months can be far too late, resulting in the loss of house, marriage, family, health etc. These are all very real consequences if assistance is not at hand. With the considerable funds required to engage the legal system, franchisees are well and truly cornered!!

Is what I am suggesting feasible? It seems unlikely that the scope of the net for franchising will expand, simply due to the considerable costs involved, but never the less, something needs to be done to address the imbalance of power and influence inherent in a Franchise Agreement. A more stringent enforcement of the Code and Act is urgently required, and the law needs more significant consequences for breaches.

Where did the ACCC come into play in my case?

Following a complaint to the ACCC, the ACCC acknowledged that there appeared to be a breach of "the Code", but it was a matter they were reluctant to pursue further because I had not really given the business an opportunity to develop and their involvement could "significantly hinder" this opportunity or any further chance to negotiate a more favourable settlement? It should be pointed out that no negotiation was even attempted by the franchisor either before or after mediation.

The ACCC also specified that whilst not offering any legal advice, it was not likely they would take such a matter to court as it would be difficult to prove damages so early in the piece, and it was pointed out that a large part of the problem was a "bad commercial decision" by me.

It has to be clearly stated that I totally agree that my decision to enter the franchise was a bad commercial decision. The business I purchased did not in any way resemble the verbal and written representations provided to me. That was why I began questioning the franchisors so early in the piece. How the bad decision came about is the real question that needs answering.

My bad commercial decision was made based upon the information provided to me. The Disclosure Document (although incomplete) was just one consideration, along with literature and other representations which have subsequently been shown to be "inaccurate". A materially relevant issue was the joint failure of the franchisors to acknowledge existing profitability concerns being expressed by other franchisees, and their failure to provide a list of existing franchisees (which was an agreed breach of the Code), by hiding behind privacy laws. The profitability concerns being expressed by existing franchisees and franchisors remained unaddressed, and amongst other things, have ultimately led to the "removal" of the franchisor from the system. Other franchisors are also in the process of being "removed", which further strengthens claims that the franchise system as a whole was certainly not what was described. Concerns surrounding profitability and support indeed do exist across the board, and this was all initially denied.

Is the franchisor acting within the bounds of the "conduct" and indeed the "good faith" of the Franchising Code of Conduct to sell a franchise in the knowledge that existing franchisees are experiencing profitability concerns?

Is the franchisor acting within the bounds of the "conduct" and indeed the "good faith" of the Franchising Code of Conduct to acknowledge a breach of the Code and also concede that certain representations of the business were shown to be inaccurate, yet fail to enter any negotiation and deny all liability?

I put it to you that it is more than reasonable to suggest that had I been provided with the full list of mandatory disclosure requirements, I would have had the opportunity to discover some of the existing problems within the franchise before entering the Agreement, and accordingly would be in a far better financial position now. The ACCC were informed of everything that happened, including the denial of liability and the events surrounding the "removal" of the franchisor, and I was simply wished well in my future endeavours.

Clearly, based on what has unfolded, this is all considered acceptable practice for a franchisor protecting their business and financial interests. Causation of damages must completely be the responsibility of the franchisee for conducting inadequate due diligence, failing to "effectively" request additional information (that is supposed to be mandatory under the Code), and ultimately making a bad commercial decision. The franchisor is obviously "squeaky clean" and completely innocent?

Why would franchisors and their representatives want the rules of the game changed?

## Franchisor Contractual Liability

From the outset of my dispute, franchisor liability to the contract was denied on the premise they were not directly responsible for, nor involved in the production of the Disclosure Document in question?

Is there not a level of "due care" required on the part of the franchisor, firstly in the preparation of and then perhaps most importantly, in the presentation of the Disclosure Document and contract that is being entered into or renewed?

How can a franchisor deny liability to an Agreement that bares his/her name and signature (and for that matter even their logo or trademark), and an Agreement they have benefitted from financially, in the form of both the initial franchise fee and ongoing monthly franchise fees?

It would seem somewhat contradictory to on one hand deny liability, yet on the other hand, maintain authority over the Agreement to alter and enforce specific or selective terms of the Agreement - namely, the franchisee must continue paying fees or the business will be terminated?

As previously stated, I have no legal background, but denying liability seems to provide yet another solid support to the franchisors already solid position, by creating an entangled and costly web for the franchisee to manoeuvre through to determine liability and prove damages.

As was explained to me, this type of behaviour is understandable and therefore acceptable given the circumstances, with the franchisor doing little more than protecting their financial interest. Might I suggest they are protecting money that they have obtained by breaching the law?

Again the question has to be asked, what is the impact or effect of a breach of the Code or the Act by the franchisor? They still hold the money, and the franchisee leaves with nothing!!!

## Conclusion

- **Although "mandatory" under the Trade Practices Act, the Franchising Code of Conduct in reality is little more than a voluntary provision**

- **Without any automatic consequence or penalty for a breach of the mandatory disclosure requirements, what are the true implications for a franchisor?**

- **Current provisions for dispute resolution and overall protection are grossly inadequate on many fronts, and rest far too heavily in favour of the franchisor.**

- **Franchisors are too readily able to use the costs of the current dispute resolution provisions as a solid defence to "protect their commercial and financial interests". They are also seemingly jointly able to deny all liability, forcing the franchisee to determine liability before the courts?**

- **When can the ACCC be definitively relied upon to assist franchisees?**

My experience in franchising has seen me walk away with nothing, despite amongst other things, an agreed breach of the mandatory disclosure requirements required under the Franchising Code of Conduct, powerless to do anything after an exhaustive trail of dead ends, due to a lack of money.

If as it is being suggested, current laws provide comprehensive protection for franchisees, how can these laws be more strictly enforced and more accessible in order to provide more force and effect, and in turn prevent what has occurred to me occurring to anybody else?

With the franchise industry a significant contributor to the Australian economy, it has to be said that in the main, franchising is a successful and appealing means for people entering the business world, and that in most cases the relationship of the franchisor and franchisee is mutually beneficial, but situations will arise where all is not well. What happens then?

It is clear that remedies available to franchisees impacted by a franchisor in breach of the Franchising Code of Conduct and/or the Trade Practices Act need to be significantly enhanced. Something needs to be put in place to level the playing field, and bridge the vast chasm that exists on many fronts, between the franchisor and the franchisee. The pendulum rests way too far in favour of the franchisor and they must be made to take full responsibility and accountability for their inherent controlling interest. Breaches of the Franchising Code of Conduct and/or the Trade Practices Act should have far greater consequence or penalty, given that breaches on the part of franchisees can result in termination.

Terms that need to be specifically addressed are "technical" or "procedural error". As it stands, the franchisor faces very little in the way or reprisal, able to say "oops – sorry about that", and perhaps extend a token offer with a bang of a fist on the table to reinforce the costs associated with legal action legal. The door is then also open for declarations of "deep pockets" and "we'll see you in court!" Regardless of the mischief brought about by the breach, the franchisee is trapped, and has to prove damages, yet cannot afford to engage the legal system?

Based upon research and my own personal experience, I find it somewhat puzzling that when a person intimidates and makes financial gain in the school playground they are a "bully", with quite severe repercussions, yet when it comes to franchising, the use of intimidation and threats to enhance or protect their business are simply seen as just that – protecting their business interests, or even simply conducting business?

Is it any real wonder that franchisees are left wandering in the wilderness with their only tool for navigation being the moral compass of their franchisor? How can this ever be justified if the current provisions and laws are adequate?

Regardless of the decision by the High Court in relation to "Ketchell", may I put it to you that this inquiry is a timely opportunity for parliament to move forward and define the true intent of where the "Franchising Code of Conduct" sits in relation to the legal framework surrounding franchising. If "the Code" is indeed intended merely as a "guide" to "regulate conduct of the participants in franchising", then tell us. If "the Code" is meant to be law with automatic consequences such as the ability to invoke common law illegality by declaring an Agreement void for a breach, then tell us? It is a perilous situation for a franchisee to rely on a code that they assume offers them protection, yet franchisors know it doesn't!!!

I for one strongly disagree with any attempt to suggest that existing laws and provisions are adequate, and I am sure many others have grave doubts over the adequacy of any protection offered under the current provisions and financially inaccessible laws. I am hopeful that if nothing else, this submission is able to clearly demonstrate the absolute imbalance that exists between a franchisor and franchisee in dispute. Please clarify the "rules" of the game, and at least make it a level playing field. Your assistance is urgently needed!!!

*Your time and efforts are much appreciated*

*THANK YOU*