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29th August 2008

The Secretary

The Parliamentary Joint Committee on Corporations and Financial Services

Department of the Senate

PO Box 6100

Canberra ACT 2600

Dear Secretary

Submission to Inquiry into the Franchising Code of Conduct

I enclose my submission to the above inquiry.

I am prepared to give oral evidence to the Committee if so requested.

No confidentiality is claimed in respect of this submission. There is no objection to this submission being posted on the internet.

I understand that submissions to the Committee become Committee documents and should not be made public before the Committee has done so. I would hope that the Committee will take a decision to make this submission public as soon as possible after its lodgment. You might please advise me when a decision in this regard has been taken.

Would you please acknowledge receipt of this submission at your early convenience.

Yours faithfully

(Warren Pengilley)

This submission is lodged by:

This submission is made to:

The Secretary

The Parliamentary Joint Committee on Corporations and Financial Services

Department of the Senate

PO Box 6100

Canberra

(Phone (02) 62773583)

SUBMISSION TO PARLIAMENTARY COMMITTEE OF INQUIRY INTO FRANCHISING CODE OF CONDUCT

by

Professor Warren Pengilley

Professor Emeritus the University of Newcastle; Solicitor of the Supreme Court of New South Wales; formerly a Commissioner of the Australian Trade Practices Commission

The author of this submission is prepared to give oral evidence to the Committee if so requested.

NO CONFIDENTIALITY IS CLAIMED IN RESPECT OF THIS SUBMISSION. IT IS UNDERSTOOD, HOWEVER, THAT SUBMISSIONS BECOME COMMITTEE DOCUMENTS AND SHOULD NOT BE MADE PUBLIC BEFORE THE COMMITTEE HAS DONE SO. IT IS UNDERSTOOD THAT THE COMMITTEE NORMALLY MAKES SUBMISSIONS PUBLIC BY, AMONGST OTHER THINGS, POSTING THEM ON THE INTERNET UNLESS THIS COURSE IS NOT AGREED TO. THERE IS NO OBJECTION TO THIS COURSE OF ACTION BEING TAKEN.

SUMMARY OF CONCLUSIONS REACHED

IN SUBMISSION

TO INQUIRY INTO THE FRANCHISING CODE OF CONDUCT

SUBMISSION TO PARLIAMENTARY COMMITTEE OF INQUIRY INTO FRANCHISING CODE OF CONDUCT

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SUMMARY OF POINTS MADE IN SUBMISSION

Basis of Submission

1. This submission is made as an independent commentary and not on behalf of any franchisor or franchisee organisation. **(PART3)**

Definitional Issues

2. (a) The major issue in relation to franchising is, in my view, the coverage of the Franchising Code. This depends upon the definition of "franchise agreement" in the Code **(Par 5.1).**

(b) The Reid Committee, upon whose deliberations the Code is based said nothing about the definition of a franchise agreement. No relevant consultation on the definition problem occurred **(Par 5.2).**

The definition of "Franchising Agreement" in the Code is set out at **Par 5.3.**

(c) The 2000 Committee of Review of the Code said that amendment to the definition was a matter for government and made no comment on the definitional issue. Its stated reasons for acting as it did were both illogical and incorrect **(Pars 5.5 to 5.7).**

(d) It is hoped that the present Committee will consider the definitional issue de novo and give reasons for its recommendation either to amend or not amend this definition **(Par 5.7** and **6.5(b)).**

(e) The definition of a franchise agreement for regulatory purposes has been examined by two major committees of inquiry in Australia [The Swanson Committee (1976) and Blunt Committee (1979)]. Franchising was also covered specifically under the prior Corporations Law **(Par 5.9).**

In short, all these evaluations stressed the need for control by the franchisor of the franchisee's overall business and for the public identification of the franchisee's overall business with that of the franchisor. Both of these factors are missing from the definition in the Franchising Code **(Par 5.9 – 5.10 and APPENDIX "A").**

(f) The Code definition of a franchise agreement has "got it wrong". Reasons for this are set out in **PART 6.**

(g) The result of the definition in the Code is that the coverage of franchising regulation is far too wide and, in many cases unnecessary. This is because quite fundamental provisions limiting the definition of franchising (and as found in various detailed definitions set out in **APPENDIX "A"**) have been omitted from the Code's franchising definition **(Pars 6.2- 6.5).**

(h) There is a confusion between a simple franchising arrangement on the one hand and a franchising arrangement with those qualities meriting specific regulatory legislation on the other. The Code encompasses both but only the latter needs specific regulation. It is important to limit regulation to the latter franchising arrangements. Government control involves significant costs and, as a method of cutting regulatory costs, regulatory policy should consider franchising regulation as being necessary only in the latter case **(Pars 7.1-7.5).**

Obligations to act in good faith

3. There are good grounds for inserting in the Franchising Code an obligation for parties to act in good faith. This obligation should be imposed on both parties and not on one party only **(Pars 8.1-8.3).**

Interaction of the Code with PART IVA of the Trade Practices Act

4. The Code's interaction with the Trade Practices Act is presently appropriate **(Pars 9.1 and 9.2).**

Dispute Resolution Provisions

5. The Code's dispute resolution provisions are inadequate. There is no provision for mediator immunity from legal proceedings. The confidentiality of mediation proceedings is not assured. The latter seems largely to be because of the administrative role of the Mediation Advisor. Principles of mediation require this position to be remedied, as per legislation in N.S.W. (and presumably other States). A statutory provision is required to do this as other Federal statutes may overrule a Federal regulation. Initially, and as a stop gap "second best" solution, an amendment to the Dispute Resolution provisions of the Code is desirable **(Pars 10.1 – 10.7 and APPENDIX "B").**

The rights of franchisees and franchisors

6. Franchising relates to a business practice and not to the problems of any specific industry. General franchising law coverage cannot be industry specific. There is a real danger that further legislation urged by a particular industry group will have unforeseen consequences for another. An obligation to act in good faith if implemented is all that can realistically be added to the present remedies to improve the rights of parties. Subject to the implementation of a requirement to act in good faith, it is very difficult to see how any deserving franchise related dispute will be left without an effective remedy **(PART 4).**

SUBMISSION

TO INQUIRY INTO

THE

FRANCHISING CODE OF CONDUCT

SUBMISSION TO PARLIAMENTARY COMMITTEE OF INQUIRY

INTO FRANCHISING CODE OF CONDUCT

INDEX OF SUBJECT MATTER

SUBMISSION

1. TERMS OF REFERENCE

1.1 In summary, the terms of reference of the Committee relate to:

(a) The nature of the franchising industry, including franchisor and franchisee rights. (Discussed at **PART 4** and **PART 7**)

(b) Whether an obligation to act in good faith should be inserted into the Code (discussed at **PART 8**);

(c) The interaction of the Code with PART IVA and PART V Division 1 of the Trade Practices Act with particular reference to Section 51AC of the Act (discussed at **PART 9**);

(d) The operation of the dispute resolution provision of PART4 of the Code (discussed at **PART 10**); and

(e) "Any other related matters". The coverage of the Code is the major aspect of this submission. This subject is within the Committee's terms of reference as a "related matter" (though this considerably downgrades its importance). The coverage of the Code is discussed in detail at **PART 5** and **PART 6**.

1.2 This submission does not comment upon the Committee's terms of reference in the order set out above. The most important point, in my view, arises under "any other related matters." The view I put is that the most important aspect of the impact of the Code is the definition of "franchise agreement". I argue that the present Code definition is misguided and fundamentally wrong (see **PARTS 5 and 6**). Other points in the terms of reference are discussed but these are subsidiary to the basic definitional issue.

2. THE WRITER'S BACKGROUND

2.1 (a) Academic and akin qualifications

I hold the degrees of B.A, LL.B. (Sydney University), JD (Vanderbilt); and M.Com; D. Sc (Newcastle). I am a Fellow of the Australian Society of Certified Practising Accountants; a Fellow of the Australian Institute of Company Directors and a Chartered Director of the Corporate Directors Association of Australia. For many years (1983-2004) I was also an Associate Fellow of the Australian Institute of Management.

The Degree of Doctor of Science is a senior degree of any University. It was awarded for "original research and writing in competition, consumer protection, credit and franchising law".

(b) Positions held

Partner Newman and Pengilley (Solicitors Tamworth) 1964-1975; Foundation Commissioner, The Australian Trade Practices Commission 1975-1982; Partner Deacons Lawyers 1983-1993; Foundation Professor of Law, The University of Newcastle 1993-2004; Special Counsel Deacons 1993-2008; Professor Emeritus, The University of Newcastle 2004 to date; Life Member Law Society of N.S.W. This life membership was conferred "in recognition of (a) long and meritorious period of practice and service to the profession".

(c) Franchising and Mediation activities

In 1981, when a Commissioner of the Australian Trade Practices Commission, I was commissioned by the then Minister of Business and Consumer Affairs, to advise on Franchising Law and Policy. This advice was subsequently published.[1]

As Adjunct Professor of Law at the University of Technology, Sydney, I designed and conducted the first course on Franchising Law and Practice at a Law School in Australia.

Invited by the Franchising Code Mediation Advisor to be a mediator under the Franchising Code but declined to accept appointment because of a belief in the inadequacy of the legal position and the administrative procedures involved (see **PART10**)

From 1993 to 2005, I was an Accredited Advanced Mediator with LEADR (Leading Edge Alternative Dispute Resolvers). I have conducted a substantial number of training courses for ACDC (the Australian Commercial Disputes Centre). I have also conducted many mediations. In commercial mediation I have been certified by ACDC (in terms of the certification) as "having outstanding experience and qualifications in the field".

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[1] Franchising – What Impact; What Problems, What Solutions? Published by Monash University 1982. This Report was commissioned largely as a reaction to the decisions in Ducret v Colourshot [(1981) ATPR 40-196] and O'Dea v Casnot [(1981) ATPR 40-198]. These two cases are discussed at **Par 6.1.1.**

PART 2: WRITER'S BACKGROUND

I have completed courses of study at Louisiana State University USA, in Strategic Franchising Marketing and Strategic Franchise Business Management.

(d) Franchising Articles

I have written a number of franchising related articles over the years, the most relevant of which for present purposes are cited below.[2] Of these articles, the most relevant is the last cited in n.2 (that published in the Newcastle Law Review). This article expressly deals generally with the Franchising Code of Conduct. Much of what is said in this present submission elaborates on points initially made in that article.

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- Distributorships, franchising and non-patent licensing-developments 1974-1978 under the Trade Practices Act. Management Forum Vol 5 No.1 (March 1979)p.48
- Franchising: What Impact, what Problems, What Solution? See n.1
- The Present Law and Likely Impact of Franchising Legislation The Australian Director (June/July 1983)
- International Franchising Agreements and Problems in their Negotiation. Paper given at the 8th Commonwealth Law Conference in Jamaica 1985. Published by Northwestern Journal of International Law & Business (Northwestern University U.S.A.) Vol 7 No.2, 1985
- Rights and Liabilities of Franchising Parties. Background Paper to Franchising Law Seminar conducted by Business Law Education Centre in 1987 in Sydney and Melbourne and by New Zealand Law Society in November 1987. (Reproduced as Chapter 3 of Franchising Law. Practice in Australia IBC 1988
- The Franchising Code of Conduct: Does its coverage address the need? Newcastle Law Review (1999) Vol 3. No.2 p1

PART 3: AN INDEPENDENT APPROACH

3. INDEPENDENT APPROACH

3.1 The sole reason for setting out details of my qualifications and experience in franchising and mediation is to inform the Committee of the fact that I have for a long period been associated with the relevant law and practice in both franchising and mediation areas. This submission is made as an independent submission based on my association with, and experience in, these areas. It is not made at the request of any franchisor or franchisee association or organisation. Nor is it made after consultation with any such association or organisation.

3.2 I am prepared to give oral evidence to the Committee if so requested.

4. RIGHTS OF FRANCHISING PARTIES

4.1 The rights of franchisors and franchisees are discussed throughout this submission and are not dealt with as a separate topic.

4.2 It is argued in this submission that the definition of franchising in the Franchising Code is too wide and should be more limited. Many franchising arrangements are, in fact, normal commercial arrangements not necessitating specific regulatory control and the cost of complying with such control. It is only when there is "power imbalance" that specific regulatory control is required. "Power imbalance" may occur because of supply dependence, because of the power of the franchisor in controlling the franchisee's business by use of a trade mark or because of the public identification of the franchisor and franchisee. All Australian Committees' conclusions and all prior laws have based the rationale of franchising control on these criteria (see **APPENDIX "A").** It is when these criteria are present that franchisees are most vulnerable and the rights of parties are the most important.

4.3 In the circumstances of franchisee dependence, the present legal protections are (subject to what is said in **4.5** below) more than adequate. The franchisee has the benefit of a detailed disclosure statement by the franchisor. The Trade Practices Act provisions, especially those dealing with misleading or deceptive conduct and unconscionable conduct, are also relevant.

4.4 The obligations of franchisors towards franchisees are, in fact, far more extensive than most seem to think. A summary of these, illustrating the width of such coverage, is set out in **Par 9.2 (b)** below. The Reid Committee in its 1997 Report overlooked all of these protections and, sadly, has created the view that franchisees are virtually without remedy.

4.5 A requirement that parties act in good faith [a requirement which I support (see **PART 8**)] would cover any omissions in legal remedies which may exist. It would fulfil much the same role as s.52 of the Trade Practices Act (i.e. as an overarching provision to cater for conduct not within other black letter law prohibitions). Compulsory mediation is also important as litigation can frequently destroy a close business relationship regardless of who wins the legal joust.

4.6 Franchising, of course, is not an industry. It is a method of doing business which transcends any particular industry. Over-detailed regulation runs the risk that it may solve the problem of one industry only to find that it creates unforeseen problems for another. If there are specific problems for particular industries which cannot be addressed in a general statute, these are best corrected by industry specific legislation.

4.7 In short, it is very difficult to see how any future legislation or any amendments to the Franchising Code can be effected without impacting adversely in terms of costly compliance and having the real possibility of adverse consequences on certain industries whose position may

not be fully appreciated. The exception to this would be an obligation on parties to act in good faith (see **PART 8**).

4.8 Subject to the comments above on requiring good faith dealing, the various remedies available, both general and franchising specific, seem to cover all foreseeable difficulties. It is hard to envisage a deserving franchising related dispute where no effective remedy is currently available.

PART 5: FRANCHISING COVERAGE

5. THE PROBLEM OF COVERAGE AND DEPENDENCE: NOT A MINOR "RELATED MATTER" BUT A CRUCIAL ISSUE

The basic problem of overkill

5.1 The major area in which the Code is misguided and fundamentally wrong is in its coverage. There is a definitional misunderstanding of the need for coverage. In essence, the definition leads to excessive coverage and to unnecessary business compliance costs.

The definitional issue lies within the terms of the Committee's review reference as "any other related matter". This term of reference might imply that the definitional problem is a rather insignificant one. In fact, it is crucial to the whole question of the coverage of the Code and its impact.

The Franchising Definition: Initial History

5.2 The Reid Committee[3], upon whose deliberations the need for the present Franchising Code was based, stressed that franchisees were subject to power imbalance. The Committee, however, failed to perform one of its most basic tasks – to define what it meant by "a Franchising Agreement". The Committee adopted a "crash through" approach commenting that:

> *"Enough time has already been lost".*

Therefore, said the Committee, franchising control must be enacted immediately. The only comment the Committee made on the definitional problem was that:

> *"definitional problems are associated with almost all legislation. Given the weight of international precedent, the Committee believes these definitional problems could be overcome."*

The Committee did not suggest how the problems could be overcome. Certainly, there is international precedent but the definition in the Code adopts none of this. Furthermore, it does not adopt the views put by prior Australian Committees which have studied the problem (see **APPENDIX "A")**

Neither was there any appropriate time in which to have any meaningful public discourse on the complex subject of franchising definition. The whole consultative process as to the definitional issue lasted 11 days[4].

The Franchising Definition arrived at

5.3 The result of the above process was a definition that encompasses four aspects, these being:

(a) the requirement that there be an agreement;

(b) *"in which a person* **(the franchisor)***grants to another* **(the franchisee)***the right to carry on the business of offering, supplying or distributing goods or services in*

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3 Report of the House of Representative Standing Committee on Industry, Science and Technology May 1997 (the Hon Bruce Reid Chairman) entitled Finding a Balance towards Fair Trading in Australia.

4 The last draft of the Code was released on 7 April 1998. Comments were required by 24 April 1998. This is 17 days. However, the Easter break and a weekend period meant that the relevant consultation period was 11 working days (assuming a state of perfect knowledge in that involved parties were aware of the release of the draft on the day of its release). The Minister spoke of "wide consultation" but, in view of the complexity of the subject matter 11 days in hardly enough to consider the matter. A number of drafts of the Code were previously available from October 1997 but these were available on a strictly confidential basis and only to selected groups. The Minister's claim to have consulted widely with all sections of the industry is rather hollow when the Franchise Council of Australia complained that it was not given any opportunity to consult (see letter to Law Society of N.S.W. Journal 11 May 1998)

Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor"; and

(c) under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol owned etc. by the franchisor or an associate; and

(d) under which the franchisor must pay or agree to pay an amount including an initial capital investment fee or a fee based on gross or net income[5]

The 2000 Review of the Franchising Code of Conduct and my submission to this review.

5.4 A review of the Franchising Code of Conduct was initiated in 1999 and the Review Report of the Franchising Policy Council was released in May 2000.[6]

5.5 I made a submission to the Franchising Policy Council in relation to its review of the Code[7]. In essence, I put the view (subsequently set out in greater detail in this present submission) that the definition of "franchise agreement" in the Code was inappropriate. The Review Committee said in this regard:

> *"A very detailed written submission (Submission M13) argued that the policy basis for the Code is to recognise and redress the bargaining power imbalance that exists between franchisor and franchisee. The submission then argued that the generic definition of "franchise agreement" in the Code is too broad and that it covers business arrangements where a trade mark is made available (for a fee) with "suggestions" as to how it is marketed. The definition in the Code was based on a definition in U.S. law but with variations. The written submission offered the following suggested re-draft of the definition in Clause 4(1) of a 'franchise agreement':*

An example of one of the suggested replacement definitions for "franchise agreement" in the Code.

'A franchising agreement is an agreement written or oral:

(a) By which a person(the franchisor) grants to another person (the franchisee) a right to carry on business and the ***franchisee's overall business*** *is to be conducted under a system or marketing plan substantially determined or controlled by the franchisor or an associate of the franchisor; and*

(b) Under which the ***overall and public identity*** *of the franchisee's business is substantially associated with a trade mark or advertising or commercial symbol;*

(i) Owned, used or licensed by the franchisor or an associate of the franchisor; or

(ii) *Specified by the franchisor or an associate of the franchisor*"

[8]

[5] Trade Practices (Industries Codes – Franchising Regulations 1999. Clause 4(1). With the exception of the requirement (b) set out above, the requirements are paraphrased.

[6] Review of the Franchising Code of Conduct: Report of the Franchising Policy Council (May 2000)

[7] W.J.Pengilley: Submission to the Department of Employment, Workplace Relations and Small Business in relation to the Franchising Code of Conduct (January 2000) A claim for confidentiality was expressly not made in relation to this submission. Nonetheless the Committee chose to give it a "Confidentiality "status.

[8] See n.7 pp25-26. Although I expressly stated that confidentiality was not sought in relation to my submission the Committee nonetheless classified it as "confidential". Submission M13 is my submission. I also believe that there are problems in the definition of "franchising fee". In order, however, to keep my prior submission confined to the major substantive definitional issue, these problems are not discussed.

I suggested that this definitional change would be more in accord with definitional provisions elsewhere utilised and as recommended by other Australian Committees (see **APPENDIX "A".**) However, my suggestion was subject to the following caveat:

> *"I take the view that the whole definition should be redrafted de novo. However, looking at the political realities (using the term 'political' in its broadest sense), this is not likely to happen. Those who drafted the original Code, and who are probably advisers on the redraft, may feel slighted by the suggestion. Politically, it is easier to amend, rather than redo. Amendments can be explained in terms such as fulfilling a need for 'clarification' rather than conceding that it was all conceptually wrong in the beginning and thus in need of a basic redraft. Bearing these issues in mind, I suggest that a redraft be along the present lines but clearly placing the power imbalance aspects into the definition. Though it is not the definition I would favour de novo, bearing in mind the comments above, the following might be considered a reasonable definition of a 'franchise agreement'[9]"*[Then follows the suggested definition set out above in the text relating to n.8]

5.6 For a body whose charter was to review the Franchising Code of Conduct, the Committee's reaction to my submission in its 2000 report surely beggars belief. It had previously recommended 35 changes to the Code (which it characterised as "minor amendments"). These were subsequently made law by regulation. But, in relation to "legislative changes" (of which the coverage of the Code was allegedly one) it concluded that the government may well want to give parties time to adapt to changes and a staged introduction may be appropriate. The best the Committee could do therefore, was to state that:

> *"The decision on whether and when legislative changes are made rests with the Minister and the Federal Executive Council of the Commonwealth."*[10]

5.7 The attitude of the Committee was both illogical and wrong. The Committee was charged with reviewing the Code. It made no recommendations in respect of the vital definitional issue other than to say that the Code was based on U.S. law "but with variations". The particular U.S. laws on which the definition was based were not stated. The "variations" are significant but not discussed. In fact, the definition seems to be based on a definition in an Australian Small Business text adopted by the Trade Practices Commission in its submission to (but not accepted by) the Blunt Committee (see n.14).

The Committee described changes to franchise coverage as "legislative" but they are not. They are no more legislative in nature than the many other changes made. All changes to the Code can be made by regulation. No legislation is required. Granted that time to adapt to changes in the Code's coverage may be appropriate, this is no reason to fail to deal at all with the substantive issue of whether change in coverage is desirable.

Not surprisingly, the Minister and the Federal Executive of the Commonwealth have not looked again at the matter. The Committee has failed in one of its most basic areas i.e. to suggest a definition of "franchising agreement". The government has not consulted in any realistic sense in relation to such a definition. The definition of "Franchising Agreement" in the Code has,

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[9] n.7 p. 4
[10] n.7 p.28

realistically speaking, never been debated outside government itself. The only involvement of non-government parties has been by persons selected by government and subjected to confidentiality as to their views.

Since the definitional question has yet to be considered and discussed in detail, in the hope that the present Committee will undertake its task more conscientiously than its predecessor, I submit again that the present definition of "franchising agreement" is misconceived. I hope on this occasion that the Committee will at least comment on the views put and make some observations as to whether a definitional change is, or is not, required and give some reasons as to why it reaches its conclusions.

The basic error in relation to the definition of a "franchising agreement"

5.8 The question of franchise definition has been examined in depth by a number of Australian Committees and reports sometimes directly and sometimes tangentially in relation to other subjects of enquiry[11].

5.9 Of all the Committees which have dealt with franchising, and legislation in relation to it, there are four authoritative sources which directly relate to franchising issues and the coverage of franchising. These are:

(a) *The Reid Committee.*[12] As noted, the Reid Committee said nothing on the definitional issue. The definitional issue was determined subsequently with considerable secrecy and with virtually no time allowed for public consultation and input.[13]

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[11] The following are some of the reports dealing with franchising either directly or tangentially: *Trade Practices Review Committee* (Swanson Committee), August 1976; *Trade Practices Consultative Committee Report on Small Business and Trade Practices Act* (Blunt Committee) December 1979; WJPengilley "Franchising-What Impact: What Problems: What Solutions? *Report to Minister for Business and Consumer Affairs, the Hon John Moore*, Monash University Monograph, 1982; the two *Exposure Draft Franchise Agreement Bills* introduced by the Labor Party in 1986 but not proceeded with; *Trade Practices Discussion Paper*, Baker and McKenzie, 1989; *Report of the House of Representatives Standing Committee on Industry, Science and Technology: Small Business in Australia-Challenges, Problems and Opportunities*, January 1990; *Unconscionable Conduct and the Trade Practices Act-A Report by the Trade Practices Commission to the Attorney-General*, July 1991; *Review of the Franchising Code of Practice*, R Gardini, October 1994; *Finding a Balance towards Fair Trading in Australia –Report by the House of Representative Standing Committee on Industry, Science and Technology* (The Reid Committee), May 1997; 1998 amendments to the *Trade Practices Act* enacted pursuant to the Government's "Small Business Package" legislation. In addition to the above reports which specifically comment on franchising legislation there have been a significant number of reports and commentaries on the need to extend legislative protection in relation to unconscionable or unfair conduct. Much of the need for the extension of this protection has been seen to be necessary to protect small business and franchisees: see *Trade Practices Act-Proposals for Change,* Green Paper issued by the Attorney-General, February1984; *Trade Practices Revision Act* 1986; *House of Representatives Standing Committee on Legal and Constitutional Affairs-Mergers, Takeover and Monopolies Report* (1989) (recommending against Trade Practices Commission view that unconscionable conduct prohibitions should be extended to commercial transactions);*Unconscionable Conduct and the Trade Practices Act: Possible extension to cover commercial transactions-Report of the Trade Practices Commission to the Attorney-General* (July1991);*Report by the Senate Standing Committee on Legal and Constitutional Affairs: Adequacy of Existing Legislative Controls* (December 1991); *Report by Working Party to Minister for Small Business on the need to amend Section* 51AA (February 1995 with Supplementary Report May 1995) ;Better Business Conduct Discussion Paper, Department of Industry, Science and Technology (October 1995); *Trade Practices Amendment (Better Business Conduct) Bill* (not enacted); Amendments to the *Trade Practices Act* 1998 enacted pursuant to the Government's "Small Business Package" legislation.

[12] n.3 For Reid Committee's evaluation see **Pars 5.2** to **5.7** above.

[13] n. 12

It is hard to know the genesis of the present Code definition but it would appear that Minister Reid adopted a Trade Practices Commission suggestion put to the 1979 Blunt Committee. This submission suggested the criteria present in the "usual" franchising agreement rather than defining what type of agreement merited detailed regulation.[14] In any event this definition was not accepted by the Blunt Committee as an appropriate one for regulatory purposes. (See **(c)** below and **APPENDIX "A")** It may well, of course, have been an appropriate description of franchising as a marketing concept.

(b) *The Swanson Committee*[15]. The recommendations of this Committee are set out in **APPENDIX "A".** It is to be noted that the Swanson Committee thought that a definition of a franchising agreement for regulatory purposes required:

> *"substantial identity of the franchisee's business (which) in fact depends upon the use of the trade mark, service mark, trade name or other commercial symbol."*

(c) *The Blunt Committee*[16]. The recommendations of the Blunt Committee are set out in **APPENDIX "A".** It is to be noted that the Blunt Committee thought a franchise agreement merited regulation only when:

> *"the franchisor exerts or has the right to exert such an influence over the business affairs of the franchisee that the business of the franchisee is publicly and substantially identified with the franchisor or business of the franchisor".*

The Blunt Committee did not believe that the franchise definition put by the Trade Practice Commission (being akin to the present definition in the Franchising Code)[17] was an appropriate one for regulatory purposes.

(d) *The prior provisions of the Corporations Law*. The prior provisions of the Corporation Law gave exemption from the "prescribed interest" provisions of the law to "franchising agreements" as there defined. Franchising agreements were subject to a Voluntary Code. This present submission does not argue that franchises should once again be brought under the Corporations Law or that its provisions should be voluntary. What is argued is that the prior provisions clearly set out a different approach to what is envisaged by the term" franchise agreement" in the Franchising Code.

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[14] The Trade Practices Commission suggested in 1979 that a "franchise" was "a system of distributing goods or services in which one organisation(the franchisor) grants the right to produce, sell or use a developed product, service or brand to another organisation (the franchisee)"[Submission of Trade Practices Commission to the Trade Practices Consultative Committee on Small Business (the Blunt Committee)(1979)See Report (Vol 2 p.515)] This definition is a description of a franchise agreement in vernacular or commercial terms and is taken from B.L. Johns, E.C. Dunlop and W.J. Sheehan "Small Business in Australia"[George Allen & Unwin (Sydney)1978 p.92]. It does not, however, describe an arrangement meriting regulatory control and the Blunt Committee required additional conditions before a franchising agreement should come within the regulatory net. (See **APPENDIX"A"**)

[15] Trade Practices Review Committee (Swanson Committee) August 1976

[16] Trade Practices Consultative Committee Report on Small Business and the Trade Practices Act (Blunt Committee) December 1979

[17] See text relating to n.13 and n.14 above and Trade Practices Commission description of a "franchise" in n.14

PART 5: FRANCHISING COVERAGE

The relevant prior Corporation Law definition of "franchise" is set out in **APPENDIX "A"**. Importantly, for present purposes, it contains requirements that the:

> *"business of the franchisee ...is capable of being identified by the public as being substantially associated with a mark identifying, commonly connected with or controlled by the franchisor..."*

AND THAT *"it may reasonably be expected that, in carrying on the business, the franchisee...is, or will be dependent on goods or services supplied by the franchisor..."*

AND THAT *"the franchisor exerts or has authority to exert a significant degree of control over the business."*[18]

5.10 In all Australian Reports and legislation which have specifically addressed the question of "franchise" for regulatory purposes, the emphasis has been on franchisor control and franchisee dependence. All such reports and legislation talk about the dependence of, and overall recognition of, the franchisee's business. (See **APPENDIX "A"**) The definition in the Franchising Code specifically refers to none of these requirements.

[18] For then relevant statutory provisions and their interpretation see Australian Securities Commission v Madison Pacific Property Management [1998]FCA 717

6. WHERE HAS THE CODE'S DEFINITIONAL COVERAGE GOT IT WRONG?

6.1.1 The term "franchise" is frequently misused and misunderstood. In the early 1980's, two cases [O'Dea v Casnot and Ducret v Colourshot (see n.1] led to a demand for franchising regulation which resulted in my being commissioned to report to the Minister on the subject (see n.1 and related text). Neither of these cases involved a franchise at all let alone a "power dependent" franchise. One case involved a home operated business and the other the appointment of a party to act as a collection point for colour film to be processed. The judiciary, however, quite wrongly in my view, stated in both cases that the arrangements were "franchises". This was because, as was held in Colourshot, "the (franchisor) did not just engage (the franchisees) as agents or employees" (Colourshot at p.42669) . It is to be noted that even though there was no franchising specific legislation relevant to Colourshot or Casnot, both were successfully prosecuted under s.59 of the Trade Practices Act covering misleading conduct in relation to business transactions.

Neither Casnot nor Colourshot involved a franchise though loose terminology led many to so believe. To a significant degree the definition in the Franchising Code is also based on loose terminology.

6.1.2 The Code definition of "franchising agreement" is taken from a Trade Practices Commission submission which describes the nature of the practice. This description is not a description for regulatory purposes and, in any event, the Blunt Committee to which the submission was made did not adopt it [19].

6.2 The Code definition does not recognise the importance of franchisor control of the franchisee by use of a trade mark giving rise to a public perception that the franchisee is publicly linked to the franchisor. This is the essence of the need for specific franchising legislation. It distinguishes franchising from a vendor/purchaser relationship, even a vendor/purchaser relationship of long standing. It distinguishes **supply of products bearing trademarks** from the **control of a business by way of a trade mark**. It was found to be basic to the findings of all the detailed reports and legislation in Australia on the subject, all or which stress the necessity for franchisor control of a business and the need for a public perception of this.[20]Nowhere in the definition in the Code are these points specifically referred to.

6.3 **The distinction between the "business of the franchisee" and the business of distributing goods or services which a franchisor grants to a franchisee** is subtle but crucial. A comparison between the franchising definition adopted by the Swanson Committee [21](and all other relevant definitions – see **APPENDIX "A"**) and the Franchising Code definition shows this subtle difference which is basic but not easy to pick on any but a close reading.

6.4.1 The present definition in Clause 4(1) of the Franchising Code gives rise to the following consequences:

(a) A vast number of trade mark licensing agreements will have the potential to be franchising agreements. This is because such agreements frequently will have quality control provisions built into them and many will suggest a marketing plan for the sale or

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[19] See **Par5.9** (c)
[20] See **APPENDIX "A"**
[21] See **APPENDIX "A"**

distribution of the goods or services which are the subject of the franchisor's licence. These will probably be sufficient to constitute a ***material association*** with the relevant business and a situation where the licensor is at least ***suggesting*** a system of marketing goods or services. There will usually be a licence fee which will be based on a percentage of income from the sale of the product produced or distributed under the licence agreement. Thus all aspects of Clause 4[22] of the franchise definition will be satisfied.

(b) The definition of "Franchising Agreement" in Clause 4(1) of the Franchising Code specifies that the Code (and thus its extensive regulatory provisions) covers a transaction when the operation of **the business** is substantially or materially associated with a trade mark etc. owned by the franchisor or an associate.[23]. The question for legal interpretation is what is meant by the term "**the business**"? There is no mention of this term other than in Clause 4(1)(c) of the Franchising Code. In Clause 4(1)(b) "the right to carry on the business of offering, or supplying or distributing goods or services" is set out as the basis of the operation of the definition. There is no reference anywhere in Clause 4(1) to the **overall business of the franchisee** and no such concept can be read into the definition. Hence, by substituting the grant made [Clause 4(1)(b)] into Clause 4(1)(c), the latter must be read as meaning that the Code is applicable **when the operation of the franchisor's grant of a right to supply or distribute goods or services** is substantially or materially associated with a trade mark etc of the franchisor. This interpretation means that a considerable number of arrangements relating solely to the product involved in the licence granted (as distinct from any question of the franchisee's overall business, its public image or any power dependence or relationships) come within the definition of a "franchising agreement".

On the above interpretation (which I, and many others believe to be the correct one) no issues are relevant other than those relating to the particular product involved and whether **that product** and the term of its licence are substantially or materially associated by way of a trade mark, advertising or commercial symbol owned by the franchisor.

6.4.2 Loose terminology can lead to incorrect conclusions as to the need for extensive control. **In TABLE I** below are some cases which have come to my knowledge where it has been argued that a regulated franchise arrangement is involved. In every case, the argument for regulation has been based on the view that "the business" involved consists of those rights which the franchisor grants i.e. those involving the supply or distribution of the franchisor's goods or services. This argument thus concludes that it is not the overall business of the franchisee that is relevant. I believe this to be a legally correct interpretation of the Code. It is also where the Code's definition is wrong in policy terms. If I am right, or even arguably right, in my view of the legally correct interpretation of the Code's definition (and there are many who share my view) there is an unanswerable case for amending the definition of "franchising agreement" in the Code along the lines of the definitions in **APPENDIX "A"** or that in **Par 5.5.**

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[22] See n.5 and related text for the provisions of Clause 4 of the Franchising Code

[23] n.5 and related text. Franchising Code Clause 4(1) (c)

PART 6: CODE DEFINITION WRONG

TABLE I

SOME EXAMPLES OF ARRANGEMENTS SAID TO BE WITHIN THE DEFINITION IN THE CODE

(In all cases, it is assumed a "franchise fee" is paid)

1. A wine company makes an arrangement with a restaurant to promote its wine by advertising and other publicity. It gives detailed instructions as to the best marketing methods based on its own research.
   (The right granted is to sell wine. This is clearly a trademarked product with which the grant of business is associated. Marketing is on the basis of a plan substantially determined or suggested by the franchisor. The wine involved may be only a small part of the "franchisee's" turnover and the restaurant is not dependent on the "franchisor" or publicly identified with it.)

2. The wine company example in 1.above is but an example of many similar practices. In such cases, these are, like the wine company example itself, really only vendor/purchase agreements. If I provide soft drinks to a corner store and assist by advice as to marketing them, the same conclusions as in the wine company example above follows. The marketing of my trademarked soft drinks is materially associated with a marketing plan suggested or substantially determined by me. There is, thus, a franchising agreement even though the sale of soft drinks is but a small part of the corner store's business.

3. The same conclusions as above follow if I set aside part of my premises for the exclusive resale of a product. If I am a newsagent and set aside part of my premises as a boutique chocolate selling stand, then the Code even more clearly applies. But the chocolate selling stand is not publicly identified with my overall business and may be but a small part of such business. My overall business is the quite different business of selling newspapers.

4. The Code runs quite generally to cases where the individuals are licensed as sales agents for a particular service provider. The product may be a small part of the overall business of the licensee but is the only product the licensor supplies of that kind. It has been argued, for example, that newsagents selling as licensed agents for State lotteries are covered by the Code. [See Discussion Paper: Review of Franchising Code of Conduct: Office of Small Business (Dec 1999)]

IT IS SUBMITTED THAT ALL OF THE ABOVE EXAMPLES MIGHT BE CALLED "FRANCHISING ARRANGEMENTS" IN COMMON PARLANCE. THEY DO NOT, HOWEVER, MERIT SPECIAL REGULATION AS THEY LACK FRANCHISEE DEPENDENCE AND PUBLIC IDENTIFICATION WITH THE FRANCHISOR. THEY ARE, NONETHELESS IT SEEMS, COVERED IN THE CODE'S DEFINITION. THIS DEFINITION SHOULD BE AMENDED TO PROVIDE THAT THEY ARE NOT.

6.5(a) It is quite wrong that the definition of a "franchising agreement" operates, or even has the potential to operate, in the manner set out in **Par 6.4**. Any of the definitions in **APPENDIX "A"** would overcome the problem. If it is not desired to engage in a detailed re-draft the simple changes I suggested in my submission to the 2000 Review Committee[24] would solve the problem by what may be an easier "political" path to tread.[25]

(b) It is highly relevant in policy terms to note that the prior Corporations Law adopted the Franchising Code's basic definition of a franchise agreement but then goes on quite specifically to provide that the business carried on must be identifiable by the public as being substantially associated with a mark controlled by the franchisor, that the franchisor must have the ability significantly to control the franchisee's business and that the franchisee's business must be dependent on goods or services supplied by the franchisor (see **APPENDIX "A"**). Definitions in

[24] See **Par 5.5** and in particular text related to n.8

[25] For the reasons for this see text related to n.9

the Swanson and Blunt Committees are not as specific but both encompass these concepts. These additional safeguards are not present in the Code definition.

If the present Committee regards the principles stated by the above evaluations as inapplicable, it should expressly give reasons for its conclusions. The evaluations of the Reid Committee show that it did not debate the issue at all (see Pars **5.1-5.7**)

7. THE NATURE OF THE FRANCHISING INDUSTRY

The economic importance of franchising

7.1 It is not necessary to comment in detail on the basic importance of franchising to the Australian economy. Statistics in this regard are cited in the Reid Committee Report. No doubt the present Committee will obtain up to date figures in this regard and so prior figures, though presumably still broadly relevant, will not be repeated here. What is important is that the Reid Committee found that franchising had a 14 per cent annual growth for the 6 years prior to 1997 and that 18 per cent of home grown franchises had been exported. These figures are impressive to say the least.

7.2 It is also relevant to note the evidence given to the Reid Committee by Professor Terry, a leading Australian expert in the field. He stated that:

- Australia has twice as many franchising systems per head as the United States; and
- 65 per cent of Australian franchising systems had less than 10 franchisees.

7.3 It is important to recognise the role of franchising as a small business contribution to the economy. The growth of franchising should not be inhibited by overbearing and costly regulation if this is not necessary. Many marketing franchises are not necessarily arrangements meriting specific control.

The concept of franchising for regulatory purposes

7.4 **(a)**There is a real danger in not distinguishing general franchising arrangements (called "franchises" in common commercial and marketing terminology and as set out in n.14) on the one hand with, on the other, franchises involving franchisee dependence and franchisee public identification with a franchisor (as set out for example in the definition in **APPENDIX "A"**). Only the latter merit specific regulation. The former do not.

(b)There are certain elements of franchising arrangements which are different from standard contractual relationships which merit regulation. These are not clearly articulated in the Reid Committee Report. However, as I see it[26]the following are relevant considerations to an evaluation of the need for specific regulatory control and some of the issues which franchising regulation must address:

- Franchising, in order to merit regulation, must be an "ongoing" relationship. It must thus be more than a single buy and sell transaction which may typically be covered by contract law.
- Because it is an ongoing relationship, genuine issues of disagreement often cannot usefully be litigated. A court case inevitably destroys an ongoing relationship, whatever the outcome of such litigation. It is, therefore, important that there be a method of resolving disputes without destroying the relationship between parties.

[26] WJPengilley: The Franchising Code of Conduct: Does its coverage address the need?(1999) The Newcastle Law Review Vol 3 No.2 1,17

- There are power imbalances in many franchise arrangements. Certainly these exist in many contractual relationships, but the fact that a franchisor in many franchising arrangements controls the use of the relevant trade mark and the marketing system involved, gives rise to particular market power imbalances. Specific regulation is not justified unless the power imbalance in a franchise arrangement is that *the whole or a substantial part* of the franchisee's business depends upon the franchisor's trade mark and marketing system.
- The fact that there are usually a number of franchisees involved gives rise to problems of equity of treatment. Further, the fact that the franchisor itself often also operates outlets which may compete at the same level as franchised outlets may well create difficulties.
- A major problem is obtaining information in advance of commitment. If a commitment to a continuing and trade name dependent relationship is involved, then franchisors should be required to disclose who they are and what their track record is. This will assist rational decision making by franchisees pre-investment rather than give rise to perhaps futile legal actions once the franchise system has bellied up and franchisee investment has been lost.

What is important is to define franchises with precision and not, in the name of power imbalance, to regulate all manner of transactions where this is not present and where traditional freedom of contract, backed up by Trade Practices Act and other protections, are the appropriate legal principles which should apply. The present definition of a franchise agreement covers a multitude of transactions which do not have the above characteristics and which merit no specific franchise control. As suggested in **Pars 6.3-6.5** above, any of the definitions in **APPENDIX "A",** or my suggested amendment in my submission to the 2000 Review Committee [27]would bring the definition of franchising within the proper philosophical parameters which merit specific legislative control.

7.5 Government frequently talks of the need to cut regulatory costs. The obligations cast upon franchisors are onerous. It is thus important that regulation not be required when not necessary. An evaluation of the types of franchises that require specific regulation should thus also be looked at in the context of an overall legislative policy of limiting the costs of business compliance with regulatory laws.

[27] See text related to n.9 for reasons why this may be an easier course of action.

8. SHOULD AN OBLIGATION TO ACT IN GOOD FAITH BE INSERTED INTO THE CODE?

8.1 I agree with an obligation for parties to a franchise agreement to act in good faith and that a provision to this effect could well be inserted into the Franchising Code of Conduct. As long ago as my report to the Minister for Business and Consumer Affairs in 1981[28], I commented that it would be good policy to enact a general obligation on each party to a franchising arrangement to disclose material facts and act in good faith. In that report, I expressed the view that a material fact might possibly be defined as:

> *" '...any fact, circumstance, or set of conditions which has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or which has any significant impact on a franchisee or prospective franchisee.[29]'*

I also commented that:

"An obligation of good faith would not be an unreasonable obligation to cast on each party in a franchising transaction. Probably this could be written into a statute by a short statement to the effect that the parties shall deal in utmost good faith. If it is desired to go further, then it is probably hard to go past the words of a Texas Bill which states that:

> *'The franchisor and franchisee shall prior and subsequent to the execution of a binding franchise or other agreement have the mutual obligation to deal fairly, openly, honestly and in good faith and to exercise reasonable care and diligence in complying with all provisions of the franchise and other agreements between them.'"[30]*

8.2 My belief that a general obligation to act in good faith should be included in the Code has strengthened since my Report to the Minister in 1981. This is because a franchise (properly defined) is an ongoing relationship involving the trust of one party in dealings with another. It is not appropriate for the law to sanction silence when disclosure should be reasonably required and would be reasonably expected. I also believe that the success of s.52 of the Trade Practices Act (prohibiting misleading or deceptive conduct) is an indication that general disclosure requirements are immensely important in filling any gaps which exist under any specific black letter law provisions.

8.3 It is essential that any good faith obligations apply to both franchisor and franchisee and not to one party only.

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[28] Report to Minister n.1 at p.11

[29] Report to Minister n.1 at p.43 citing 16 CFR 436.2 (1979) from D.L.Block "The New Federal trade Commission Franchise Disclosure rule: Application to Distributorship Arrangements 35 The Business Lawyer (Jan 1980)

[30] Report to Minister n.1 at 43 citing Texas Senate Bill s.18.06 (1971) See K.E.Krischir: Franchising Regulation-An Appraisal of Recent State Legislation Boston College Industrial and Commercial Law review (Feb.1972) Vol 13 No. 3 pp529-67

9. THE INTERACTION OF THE FRANCHISE CODE WITH THE TRADE PRACTICES ACT: IN PARTICULAR IN LIGHT OF SECTION 51 AC

9.1 Section 51 AC of the Trade Practices Act deals with unconscionable conduct. Subject to what is said in **PART 8** I believe that there is no case for extending this section by amendment to the Code. I believe that the present interaction of the Code with s.51 AC and PART IVA of the Trade Practices Act is appropriate and there is no case for variation of this interaction. Nor, in my view, is there any case for amending PART IVA of the Trade Practices Act to differentiate franchising conduct from other conduct covered by it. Non compliance with the Franchising Code should, in my view, only be a factor in unconscionable conduct and not itself constitute unconscionable conduct. Neither, in my view, should non compliance with the Franchising Code be a criminal offence in light of the present view that the Act is fundamentally enforced by civil remedies. I originally thought to the contrary in some respects in my 1981 Report to the Minister but developments in Australia would indicate that a gaol sentence in these circumstances would not accord with current trends.

9.2(a) It would be a mistake to think that there are not already a large number of protections, many of which carry criminal sanctions, available to franchisees. The Reid Committee overlooked many of these. It is appropriate to note that many of these protections (see **(b)** below- citations to cases being their reported status at the time of the Reid Committee's evaluations) were available at the time of the Reid Committee Report .

(b) The law is that, in the case of a franchise agreement, the courts will imply a term that:

> *"...the (franchisor) company would act in good faith in the sense that it would not discriminate against a particular dealer for no good reason and that it would not act with reckless indifference towards the needs of any particular dealer."*[31]

There is a duty on a franchisor:

> *"to ensure that, over time, one dealer (is) not significantly disadvantaged by comparison with others, having regard to all relevant circumstances."*[32]

A franchisor has certain duties in the treatment of franchisees. Thus, a franchisor cannot impose terms on a franchisee that the franchisee may be terminated in the event that the franchisee institutes legal proceedings against the franchisor. This is because it is not possible at law to create rights and at the same time deny the other party in whom those rights vest their right to invoke the jurisdiction of the courts to enforce them.[33]

A franchisor must genuinely investigate a complaint made against a franchisee and cannot terminate a franchisee because of a complaint without conducting such an investigation. This is so even if the franchise agreement itself gives a wide discretion to the franchisor and the termination was because the franchisor feared for its image.[34]

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[31] *Kellcove v Australian Motor Industries* [Federal Court of Australia: 6 July 1990 (Unreported)]. Such a term must be implied into a franchise agreement because "it goes without saying".

[32] n.31

[33] *Novamaze Pty Ltd v Cut Price Deli Pty Ltd* (1995) ATPR 41-389

[34] *Carr v McDonald's Australia Limited* [Federal Court of Australia 16 February 1994 (unreported)] The complaint was an non substantiated complaint by a female employee of sexual harassment.

If a franchisor does not select an appropriately qualified franchisee or fails to train and supervise the business of a franchisee, the franchisor will be liable in damages to the franchisee to the extent that the franchisor's omission causes loss to the franchisee.[35] Clearly this holding imposes training and supervision requirements on a franchisor.

It is well established law from the two *Barbara's House and Garden Cases* [36]that misrepresentations as to turnover figures will render a franchisor liable as will incorrect generalised statements such as "there is no risk of loss". A statement of opinion made by a franchisor conveys that there is a basis for it that it is honestly held, and, when expressed as the opinion of an expert, that the opinion is honestly held based upon relevant expertise.

The Colourshot and Casnot cases (see **Par 6.1.1**) show how general law (in this case s.59 of the Trade Practices Act) can give protection when this is needed. The conduct in both of these cases was judicially described as constituting a franchise though, clearly enough, this was not so in either case. The general provisions of the Trade Practices Act are available to, and have been successfully utilised by, many franchisees. The cases referred to above in this paragraph **9.2(b)** are illustrative of how, in particular, s.52 of the Trade Practices Act (prohibiting misleading or deceptive conduct) has been invoked by franchisees.

The cases cited in this paragraph illustrate that in many areas there are existing effective laws which govern the conduct of franchisors quite independently of any specific legislation relating to franchising.

[35] *Haynes v Top Slice Deli Pty Ltd* (1995) ATPR (Digest) 46-147

[36] *Bateman v Slayter* (1987) ATPR 40-762; *Spears & Ors v Barbara's House and Garden Retail Ltd* [Industrial Commission of NSW: Bauer J: Matter No.1420 of 1985: Judgment 30 March 1987]

10. THE OPERATION OF THE DISPUTE RESOLUTION PROVISIONS OF PART 4 OF THE CODE

10.1 I was invited to accept an appointment as a mediator under the Franchising Code. In normal circumstances, I would have been happy to do this. However, I felt unable to do so because of the conditions imposed by accepting such an appointment.

10.2 It is basic to mediation that mediation procedures are confidential; that the mediator has immunity in respect of the mediation and that the mediator is not required to give evidence in any court proceedings. These terms are legislated in relation to various courts.[37]

10.3 So far as I am aware, there are no provisions akin to the above in relation to the Franchising Code mediation and no general Federal legislation covering the position. I concede, however, that, because of my non-acceptance of a position as a mediator under the Franchising Code, I have not researched the position in detail. Some immunity may be able to be gained by agreement between the parties but the situation should, as far as constitutionally possible, be specifically covered by statute. I doubt if a Franchising Code regulation would be sufficient as this would have to give way to a statutory provision in a case of conflict of a regulation with, say, a Federal Court statute setting out court rules of procedure.

10.4 The confidentiality situation is of particular concern to me. Confidentiality is crucial to the credibility of mediation. I see no problem in the mediator giving a factual certificate under Clause 30A (4)of the Franchising Code as to the fate of the mediation. However, the procedure adopted in administering the Code requires much more than this be disclosed. There is a requirement (not referred to in the Code) that a mediation be conducted "in accordance with procedures (the Office of Mediation Adviser) has established".[38]

The Mediation Adviser's procedures require detailed advice as to the mediation to be given to the Mediation Adviser – something I believe to be quite contrary to mediation principles, the confidentiality of mediation and, indeed, contrary to the suggested mediation agreement to be entered into by the parties. Far from granting privilege for mediation, the procedures provide that the mediator and any party may be required to give evidence of it in Court proceedings.

10.5 My concerns as to the procedure adopted in relation to franchise mediation are expressed in my letter to the Law Society Journal in 1999 and set out in **APPENDIX "B".**

10.6 Since making the decision not to accept appointment as a franchising mediator, I have not followed the procedures of the Mediation Adviser. I write on the basis that they continue to be as previously but I recognise that this may not be so. On the basis that the procedures are unchanged, the following should be done to bring franchise mediation into line with other

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[37] For example, in New South Wales, The Courts Legislation (Mediation and Evaluation) Amendment Act which took effect on 14 November 1994. This Act covers the Compensation Courts Act 1984; the District Courts Act 1973; The Industrial Relations Act 1991; The Land & Environment Courts Act 1979; the Local Courts (Civil Claims) Act 1970 and The Supreme Court Act 1770. The Courts Legislation Amendment Act 1995 amended the Dust Diseases tribunal Rules to similar effect. The Administrative Tribunal Act 1997; The Agricultural Tenancies Act 1990; The Civil Procedure Act 2005; The Community Land Management Act 1989; the Farm Debt Mediation Act 1994; The Legal Profession Act 2004; the Strata Schemes Management Act 1996 and The Workplace Injury Management and Workers Compensation Act 1995

[38] See my letter to Law Society of NSW Journal (1 February 1999) citing advice of the Mediation Adviser. This letter is reproduced as **APPENDIX "B"** to this submission.

mediation procedures:

(a) Statutory protection (in the form of a Statute not a Regulation) should be enacted to reflect an appropriate approach re immunity, confidentiality etc. The NSW statutory position may be regarded as an appropriate model.[39]

(b) Clauses granting mediation confidentiality, mediator immunity and provisions to the effect that the mediator and parties to the mediation are not to give evidence in legal proceeding of any matter occurring in the mediation should be added to the mediation provisions of the Code. There are numerous precedents for these principles and the wording of them.[40] These Code amendments may possibly be removed if a relevant Federal statute is subsequently enacted but this may take time and there is a case for a speedy "second best" solution in the meantime.

(c) The Mediation Adviser should not require the giving of any information other than that specified in Clause 30A (4) of the Franchising Code. This change will require no amendment to the Code but only a Ministerial direction. However, to put the position beyond doubt and to give greater credibility to the mediation, there should be added to Clause 30A of the Franchising Code a further subclause reading:

> *"(6) The mediator is not to divulge any information in relation to the mediation other than required in order to perform his or her duties under this Clause."*

10.7 There is a very pragmatic reason for legislation granting mediator immunity for franchising mediations. In a number of cases, insurance premiums for mediators are reduced, often considerably so, if mediations are conducted under statutory immunity. This, obviously enough, is because the risk of mediator liability is lessened. Mediators may be reluctant to engage in franchising mediations because of increased insurance premiums in the absence of statutory immunity.

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[39] See n.38 and related text. A statute should be enacted because an amendment to the Code by regulation may be contrary to the provision of other statutes and, in this event, the regulation would have to give way to the statute in the case of conflict.

[40] See statutes cited at n.37

11. IN CONCLUSION

This submission has reached certain conclusions in relation to a review of the Franchising Code of Conduct, these being briefly set out below:

11.1 The definition of a "franchise agreement" is philosophically wrong. It includes a number of arrangements which do not merit specific regulatory control. The definition of franchising agreement is inconsistent with the findings of all other committees and legislation on the subject (see **APPENDIX "A"**). A very simple amendment (See **Par 5.5** and in particular text relating to n.8) would correct the position if a de novo redraft is thought inappropriate. All these issues are discussed in **PART 5**.

Why the Code's definition has "got it wrong" is covered in **PART 6**. Basically the Code has adopted a definition of "franchise agreement" as used in marketing or commercial terms. This is a very different issue from the type of franchising requiring regulation, the essence of which is "power imbalance".

11.2 Franchising is important to the Australian economy but it is necessary to get principles right. The industry characteristics which merit specific franchising regulation are set at **Par 7.4**.

Franchising obligations under the Code are onerous. These obligations should also be assessed in light of any governmental policy to reduce regulatory compliance costs. Basic to this evaluation is the question of whether there is currently excessive regulatory coverage. I believe that this is the case. These issues are covered in **PART 7.**

11.3 An obligation to act in good faith is a justifiable addition to the Franchising Code (**PART 8)**

11.4 Subject to the conclusions reached in **11.3** above, there is no case for any variation to the present interaction of the Code with s.51AC and PART IVA of the Trade Practices Act. There are already significant protections to franchisees, some of which are criminal(see **Par 9.2(b)**). There is no case for making breach of the Code criminal in view of the general policy of enforcement of the Act being civil in nature. **(PART 9)**

11.5 The mediation provisions of the Code need significant attention. There are no provisions for mediator immunity or confidentiality of mediation proceedings. An immunity etc. Statute (not a Regulation) similar to State statutes should be enacted at the Federal level. In the meantime, as a temporary "second best" alternative the Code should be amended to cover this issue.**(PART 10)**

The mediator should not be required to divulge information to the Mediation Adviser other than the factual result of the mediation **(PART 10).**

11.6 There is no clear case for the enactment of further legislation other than the enactment of an obligation to act in good faith. Subject to this, the present remedies seem effective. There is a danger in enacting remedies to cater for specific industry problems that unforeseen consequences will impact on other industries. It is difficult to see any franchising related dispute as having no effective remedy. Compulsory mediation is of valuable assistance in the settlement of disputes **(PART 4).**

APPENDICES

APPENDIX "A"

DEFINITIONS OF A "FRANCHISE AGREEMENT" AS FOUND BY AUSTRALIAN COMMITTEES OF ENQUIRY ON THIS ISSUE AND AS PROVIDED UNDER PRIOR CORPORATIONS LAW.

[Referenced in Para 4.2; 5.2-5.5; 5.9-5.10; 6.2-6.5; 7.1-7.4 and 11.1 of Text]

APPENDIX "B"

LETTER TO N.S.W. LAW SOCIETY JOURNAL DETAILING MEDIATION PROCEDURES AS SPECIFIED BY THE FRANCHISING CODE'S MEDIATION ADVISER

[Referenced in Para 10.5 of Text]

APPENDIX "A" – OTHER AUSTRALIAN FRANCHISING DEFINITIONS

APPENDIX "A"

DEFINITIONS OF A "FRANCHISE'

1. THE SWANSON COMMITTEE

1977

The Swanson Committee thought that, before legislative intervention was merited, the franchise agreement had to be one of three types, these types being:

"(a) a contract whereby the franchisee is granted the right to engage in a business of offering, selling or distributing goods or services under a market plan prescribed in substantial part by the franchisor and where the operation of the franchisee's business is to be substantially associated with the franchisor's trade mark, service mark, or trade name, or other commercial symbol; or

(b) a contract whereby the franchisor grants to the franchisee the right to resupply whether as principal or agent, goods supplied to the franchisee by the franchisor but only when the substantial identity of the franchisee's business in fact depends predominantly upon the use of the trade mark, service mark, trade name or other commercial symbol; or

(c) a contract whereby a franchisor grants to the franchisee the right to use the franchisor's trade mark, service mark, trade name or other commercial symbol in connection with the contract and where the substantial identity of the franchisee's business in fact depends primarily upon the use of the trade mark, service mark, or trade name, or other commercial symbol."

2. THE BLUNT COMMITTEE

1979

The 1979 Blunt Committee put the concept of franchise protection this way:

> *"The concept adopted by the Committee is that of a continuing commercial relationship whereby one party (the franchisor) grants to another party (the franchisee) the right to conduct a separate business which is, however, indelibly and publicly linked with the identity of the franchisor. The link to the franchisor will always involve the licensing of the use of a relevant trade mark or name and/or user of particularly distinctive shapes or colours if they are not a registered mark. The Committee does not wish to cover "loose" commercial arrangements, not reduced to written form."*

The Blunt Committee recommended that legislation applying to franchising arrangements define "a franchise" as follows:

> *" 'Franchise' means any continuing commercial relationship whereby a person (the franchisee) supplies or seeks to supply goods or services which are identified by a trade mark, service mark or trade name, under licence from another person (the franchisor) and the franchisor exerts or has the right to exert such an influence over the business affairs of the franchisee that the business of the franchisee is publicly and substantially identified with the franchisor or business of the franchisor."*

APPENDIX "A"- OTHER AUSTRALIAN FRANCHISING DEFINITIONS

The Committee's definition went on to exclude from the definition of a franchise unwritten arrangements, partnerships and employment relationships, relationships not involving a franchise fee in excess of $500 and trade mark etc licences constituting a single transaction.

3. THE PRIOR CORPORATIONS LAW

The prior Corporations Law exempted franchising agreements as there defined from the "prescribed interest" provisions of the Corporations Law. For a general discussion see Australian Securities Commission v Madison Property Management Pty Ltd [1988] FCA 717. The term "franchise agreement" was defined in 7.102 of the Corporations Regulations as follows:

> *"...an agreement or arrangement whether express or implied, oral or written, between 2 or more persons by which:*
>
> *(a) a party to the agreement or arrangement (in this definition called 'the franchisor') authorises or permits another party (in this definition called 'the franchisee'), or a person associated with the franchisee, to exercise the right to engage in the business of offering, selling or distributing goods or services in Australia or in an external Territory, under a marketing plan or system controlled by the franchisor or a person associated with the franchisor; and*
>
> *(b) the business carried on by the franchisee or the person associated with the franchisee, as the case may be, is capable of being identified by the public as being substantially associated with a mark identifying, commonly connected with or controlled by the franchisor or a person associated with the franchisor; and*
>
> *(c) the franchisor exerts, or has authority to exert, a significant degree of control over the business; and*
>
> *(d) it may reasonably be expected that, in carrying on the business, the franchisee or a person associated with the franchisee is or will be, substantially dependent on goods or services supplied by the franchisor or a person associated with the franchisor;"*

APPENDIX "B"- MEDIATION ISSUES – LETTER TO LAW SOCIETY

APPENDIX "B"

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Letters

TO THE EDITOR

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Mediators under franchising code of conduct

SIR: A number of people who are mediators may have received a letter in October from the Office of Mediation Adviser asking them whether they wished to be included on the mediation panel to be established under the new mandatory Franchising Code of Conduct. One requirement of appointment was that the mediator: "Be prepared to conduct mediations in accordance with the procedures we have established and in accordance with the Franchising Code of Conduct."

I thought it reasonable, before indicating my willingness to act, to enquire what the "procedures we have established" were. My enquiries led to the reply that, notwithstanding the statement in the letter sent to me, the mediation procedures had, in fact, not been finalised.

Subsequently, I was sent a copy of the procedures and asked whether I wished to be appointed as a mediator under the code. I have stated that I am not prepared to accept an appointment in light of the procedures established. I think mediators who may perhaps have signed the initial letter without checking the procedures should know what is involved. For this reason, I write this letter.

The procedures which "we (i.e. the Office of Mediation Adviser) have established" provide among other things, that:

1. Various information is to be regarded as confidential but: "any party may give evidence of the settlement agreement including evidence from the mediator and any other person engaged in the mediation" (Clause 11).
2. That parties are to report in detail on the mediation to the Office of Mediation Adviser. It appears as if this report is confidential to the Office.
3. That the mediator is to report in detail on the mediation to the Office of Mediation Adviser. Presumably this, too, is confidential. However, it requires the mediator to assess matters such as the good faith of the parties in resolving the dispute – something which, depending upon the drafting of the mediation clause in question could have far reaching consequences.

Item 1 is at odds with all current mediation principles, as I understand them. Items 2 and 3 are not covered at all in the mediation agreement but, presumably, will be carried out "administratively" by the Office of Mediation Adviser. In particular, it is of concern that the mediator's report (Item 3) is not covered by the agreement appointing the mediator. It is thus something "extra curricula" to the mediation, completely unauthorised by the appointment agreement, presumably, if given, is a breach of that agreement and a report upon which the mediator, if he or she gives it, could be liable to action for the views expressed in it.

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