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Our Ref: RCG:166937

12 September 2008

By Express Post
The Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
Department of the Senate
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CANBERRA ACT 2600

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Dear Committee Secretary

Submission to the Inquiry on the Franchising Code of Conduct

My involvement in the franchising sector has spanned approximately 14 years. In this time I have had the opportunity to advise parties on both sides of the franchising relationship. My main focus has been to advise motor vehicle dealers and dealer councils in relation to motor vehicle dealer agreements entered into with motor vehicle distributors.

I have watched the progression of legislation governing franchising law in Australia from the voluntary Franchising Code of Practice (**Voluntary Code**), to the mandatory Franchising Code of Conduct (**Code**) which is now in place. In 1994 I was appointed by the Federal Minister for Small Business to conduct a Review of the Franchising Code of Practice (as it then was). In 1995 I became the Independent Chairman of the Franchising Code Administration Council Limited which administered the Voluntary Code.

I have been engaged as a consultant to the ACCC on franchising, I have mediated a number of franchising disputes and I am a current member of the ACCC Franchise Consultative Panel, the Panel of the Office of the Mediation Adviser and the NSW Supreme Court Panel of Mediators.

In my positions as Head of the Commercial Practice Group, Chairman of Partners and Partner in the Automotive Industry Group at HWL Ebsworth Lawyers I provide daily advice on franchise agreements in the motor vehicle industry, disclosure documents and I advise and act in franchise litigation.

In my view the Code as it currently stands does not provide adequate remedies for franchisee parties to an agreement. In particular the scope of section 51AC of the Trade Practices Act (Cth) (**TPA**) is not sufficient to adequately protect the interests of motor vehicle dealers, as often the conduct of motor vehicle distributors will fall short of the requirements needed to satisfy a breach of this provision.

This view has been affirmed by Senior Counsel at the Sydney Bar, with whom I have raised the issue of the adequacy and effectiveness of section 51AC TPA on numerous occasions. On one occasion I received joint-opinion from leading Counsel who took the view that termination of a franchise agreement on 12 months notice, without default by the dealer, would not satisfy the elements of unconscionability, despite the length of the franchise relationship exceeding 20 years, and the fact that the dealer had spent a considerable sum of money on improvements to the business premises shortly prior to the termination. In addition to this, the timing of termination was such that the dealer had insufficient time to recoup the money expended on the improvements.

In this particular circumstance the agreement in question allowed for termination at will, by either party on 12 months notice. For this reason, the termination fell outside the scope of section 51AC because the conduct of the distributor was within the confines of its contractual rights under the agreement and not in breach of the Code.

This situation typifies the significant problems that exist with the current scope of section 51AC, and its inability to provide adequate redress and remedies for motor vehicle dealers. This also defeats any misconception that the inequality between the parties is isolated to occasions where negotiating a remedy on cessation or dispute of an agreement. Rather the inadequacy of the TPA and the Code is evident from the very out set when the parties are entering the dealer agreement.

The one-sided nature of dealer agreements means that without the capacity and bargaining power, dealers willingly enter agreements which contain oppressive contractual clauses. This is evident of the reliance and expectation of dealers on the implied term that their relationship will be governed by good faith, and additionally the inability of a potential dealers to negotiate agreements to remove unfavourable and disadvantageous clauses.

The long-term result of oppressive clauses means that the distributor can use the contractual provisions to the detriment of the dealer during the course of the business relationship. The dealer remains in a position with little hope of redress, because they have entered a binding contractual agreement, which has extinguished their right to adequate remedy. As with the aforementioned example of a termination at will, section 51AC has an extremely high benchmark and distributor's operating within their contractual rights will prima facie fall short of breaching the unconscionability provisions.

In previous years the issues of good faith and unconscionable conduct could be, to some extent, subsumed in the application of the Unfair Contracts provision in Part 9 of the *Industrial Relations Act* 1996 (NSW) (**IRA**). Section 106 of the IRA sets out the powers of the New South Wales Industrial Relations Commission to declare contracts void or to vary them where they were deemed to be unfair. However, in the High Court's key decision in *Fish v Solution 6 Holdings* (2006) 225 CLR 180 (**Solution 6**), it was held that the jurisdiction of the Commission to consider unfair contract disputes required a contract *"whereby a person performs work in an industry"*. In Solution 6 the dispute involved a Share Sale Agreement, and was found to fall outside this requirement. Since the decision in 2006, this view has extended to exclude the jurisdiction of s 106 to commercial contracts and thus is not a remedy available to the parties to a motor vehicle dealer agreement unless the jurisdictional requirements can be satisfied.

The inadequacy of section 51AC TPA and the inability to seek recourse under section 106 IRA mean that the resulting avenues of remedy for parties to a dealer agreement are limited. Presently the Code encourages the use of mediation as a method of resolution where disputes arise.

The paper *Franchise Mediations: Experience, problems and solutions (reflections of a franchise mediator)* by Mr John Levingston (attached to this submission) gives an overview of the mediation process under the Code. As a Barrister, Arbitrator and Mediator, Mr Levingston has relevant knowledge and extensive experience in the conduct of franchising mediations. I fully endorse the recommendations made therein regarding the weakness of the Code and the need to include an express provision to act in good faith. I also support the identification Mr Levingston makes of the deficiencies and problems of the mediation process under the Code, including the inequality of negotiating power, and the tendency for franchisees to be unrepresented or without independent legal advice.

Furthermore, it is my submission that the high settlement rate of motor vehicle dealer disputes under mediation is not representative of a high rate of dealers receiving equitable resolutions to their disputes. Although mediation is being sought more frequently by dealers, this is merely indicative of their inability to seek adequate redress in the court system, and not a testament to the effectiveness of the settlement process. It should not be forgotten that 'settlement' can encompasses any one scenario on a continuum of outcomes, including (at best) the circumstance of a satisfactory outcome for both parties, to the more realistic results whereby a dealer is reluctant but can live with the terms of settlement, and finally (arguably the most common outcome) where a dealer has little choice but to accept any offer in the absence of either adequate legal redress or the ability to fund costly legal proceedings.

An additional concern with the current Code is the uncertainty surrounding foreign franchisor disclosure obligations. This has significant application to motor vehicle dealers who are engaged in business with overseas distributors. The amendments to the Code in March 2008 removed the exclusion at former clause 5(3)(a) which exempt companies domiciled outside Australia, who granted only one master licensee in Australia, from complying with the Code. Without this exemption, there is a growing uncertainty surrounding the requirement for foreign franchisors to provide disclosure documents (pursuant to section 6B) to potential dealers, in addition to, or jointly with the Australian master dealer. It is my submission that ambiguity of disclosure requirements should be addressed to ensure that foreign franchisors are complying with the Code where required, and potential dealers are receiving the requisite disclosure documents.

Finally, I would like express my interest at appearing before the Committee Inquiry at its public hearing to expand on the matters raised in this submission.

Please note that the views expressed in this submission are the personal views of myself and do not necessarily reflect the views of HWL Ebsworth Lawyers.

Yours faithfully

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Franchise mediations: Experience, problems and solutions (reflections of a franchise mediator)

John Levingston*

The Franchise Code of Conduct requires parties to a franchise agreement to use mediation for resolving franchise disputes. This article examines the mediation experience, some problems which have emerged and discusses the formalisation of a good faith obligation for parties attending a franchise mediation.

INTRODUCTION

Franchise disputes involve commercial issues and come within the equitable jurisdiction of the courts invoking equitable issues such as good faith and unconscionability, the statutory obligations arising under the *Trade Practices Act 1974* (Cth),[1] and regulation of the franchise industry.[2]

The objective of mediation is to provide a structured process involving the mediator in assisting the parties by encouraging and facilitating their discussion, so they can communicate effectively about their dispute, with the ultimate outcome of reaching agreement.[3]

With regard to franchise disputes, the Office of the Mediation Adviser (OMA) is the organisation appointed by the Minister to manage the part of the Franchise Code of Conduct which relates to mediation.

BACKGROUND

The Trade Practices Commission[4] had early experience of franchisee[5] complaints about the conduct of franchise promoters in Australia soon after its formation in 1974 which led to successful prosecution of franchise promoters,[6] identification of issues for regulation, and eventually after 20 years of experience, the introduction of the Franchise Code of Conduct (which commenced on 1 July 1998).

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[1] See *Trade Practices Act 1974* (Cth) (TPA), Pt IV, ss 45-51AAA; Pt IVA, ss 51AAB-51ACAA; Pt IVB, ss 51ACA-51AEA; Pt V, Div 1, ss 51AF-65A.

[2] *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth), r 3, which applies s 51AE of the TPA and makes the Code of Conduct in the Schedule prescribed and mandatory: see Franchising Code of Conduct, Schedule.

[3] *ACCC v Lux Pty Ltd* [2001] FCA 600 at [28], [30]-[31] (Nicholson J).

[4] The Trade Practices Commission was the original body created under the Act, and was replaced by the Australian Competition and Consumer Commission (ACCC) in 1995.

[5] The author's experience in 1979-1981 was that there were two broad groups purchasing franchises: superannuants looking for something to do in their retirement, and the recently unemployed seeking self-employment. The first group had the lump sums to invest and the second group had the motivation to borrow money to invest.

[6] See *Wilde v Menville Pty Ltd* (1981) 50 FLR 380 and *Ducret v Colourshot Pty Ltd* [1981] ATPR 40-196 (Smithers J), which involved a course of systematic, heartless and fraudulent exploitation of persons. The author was one of the investigating officers in *Colourshot*.

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Legislation

The *Trade Practices Act* provides for regulations establishing industry codes,[7] which may be prescribed and declared to be a mandatory[8] or voluntary, and prohibits contravention of an industry code.[9] Franchising is declared by the Act to be an industry and franchisors and franchisees are participants in the industry of franchising.[10]

The Code

The Franchising Code of Conduct was the first mandatory code under the Act.[11]

The Code defines a franchise agreement[12] very broadly to include a written, oral and implied agreement:[13]

- by which the franchisor grants the franchisee the right to carry on the business of offering, supplying or distributing goods or services in Australia;
- under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate;[14]
- which is substantially or materially associated with a trade mark, advertising or commercial symbol owned, used or licensed, or specified by the franchisor or its associate;[15]
- under which the franchisee must or agrees to pay an amount before starting or continuing the business:[16]
  - for an initial capital investment fee; payment for goods or services;
  - the percentage of gross or net income (eg a royalty or franchise service fee or some other description); or
  - training or training school fee.[17]

However, this does not include payments for goods or services at or below their usual wholesale price; a loan from the franchisor; usual wholesale price of goods taken on consignment; market value for purchase or lease of real property, fixtures, equipment or supplies needed to start or continue business under the franchise agreement.[18]

The Code sets out a complaint handling procedure[19] between the complainant and respondent[20] which since 1 October 1998 involves the following:

- Complainant tells the respondent in writing of:[21]
  - nature of the dispute;
  - outcome sought; and

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[7] Defined in s 51ACA(1) of the TPA.

[8] TPA, s 51AE.

[9] TPA, s 51AD: "A corporation must not, in trade or commerce, contravene an applicable industry code."

[10] TPA, s 51ACA(3).

[11] See Zumbo F, "First Mandatory Industry Code of Conduct Prescribed under the Trade Practices Act" (1999) 7 TPLJ 46.

[12] A franchise agreement is defined in the Code, s 4(2)(a)-(b) as being a transfer, renewal or extension of a franchise agreement and a motor vehicle dealership agreement. Clause 4(3) does not include the following relationships: employer and employee; partnership; landlord and tenant; mortgagor and mortgagee; lender and borrower; co-operatives or the *Corporations Act 2001* (Cth).

[13] *Franchising Code of Conduct*, cl 4(1)(a). Meaning of "franchise agreement".

[14] *Franchising Code of Conduct*, cl 4(1)(b).

[15] *Franchising Code of Conduct*, cl 4(1)(c).

[16] *Franchising Code of Conduct*, cl 4(1)(d).

[17] *Franchising Code of Conduct*, cl 4(1)(d)(i)-(iv).

[18] *Franchising Code of Conduct*, cl 4(1)(d)(v)-(viii).

[19] *Franchising Code of Conduct*, Pt 4, cll 24-31 (Resolving Disputes).

[20] *Franchising Code of Conduct*, cl 24.

[21] *Franchising Code of Conduct*, cl 29(1).

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- what action the complainant thinks will settle the dispute.

- Parties try to agree how to resolve the dispute.[22]
- Either party may refer the dispute to a mediation if no resolution within three weeks[23] or ask the Mediation Adviser to appoint a mediator.[24]
- The Mediation Adviser must appoint a mediator within 14 days of the referral.[25]
- The parties must attend the mediation and try to resolve the dispute[26] and are deemed to attend if they are represented at the mediation by a person with authority to enter an agreement to settle the dispute.[27]

The mediator must tell the Mediation Adviser within 28 days that the mediation has started,[28] and the mediator has authority under the Code to decide the time and place for mediation,[29] which must be held in Australia,[30] and to terminate the mediation by issuing a termination certificate.[31] The mediator must issue a termination certificate if the dispute has not been resolved after 30 days from the start of mediation[32] or either party asks for termination,[33] but has a discretion to terminate at any time unless satisfied that a resolution is imminent.[34]

Legal proceedings?

The Code does not affect the right of a party to take legal proceedings under the franchise agreement.[35] However, there are two matters for consideration before commencing litigation in the courts. First, a clause of the franchise agreement may contractually bind the parties to an alternative dispute resolution (ADR) procedure which excludes litigation, for example, by requiring the parties to comply with the preliminary negotiation procedure and mediation procedure under the Code, and then submitting to private arbitration.

Secondly, the courts have power under their rules to require parties to attend mediation before hearing and determining the dispute.

A typical contractual clause

A formal contractual process usually arises when the franchisor issues written notice to the franchisee identifying an alleged default of an obligation under the franchise agreement, requiring the franchisee to remedy the default within a specified time, failing which the franchisor will terminate the franchise agreement.

This is a traditional form of default notice clause, but it is in conflict with the mediation process required under the Franchise Code because it purports to initiate a process for the franchisor to terminate the franchise agreement before mediation has been commenced. This is one of the deficiencies of the Franchise Code, since completion of mediation should be a precondition for the termination process, except perhaps where the franchisee has abandoned the franchise.

[22] *Franchising Code of Conduct*, cl 29(2).

[23] *Franchising Code of Conduct*, cl 29(3)(a).

[24] *Franchising Code of Conduct*, cl 29(3)(b).

[25] *Franchising Code of Conduct*, cl 30(1).

[26] *Franchising Code of Conduct*, cl 29(6).

[27] *Franchising Code of Conduct*, cl 29(7).

[28] *Franchising Code of Conduct*, cl 30(2).

[29] *Franchising Code of Conduct*, cl 29(5).

[30] *Franchising Code of Conduct*, cl 29(5A).

[31] *Franchising Code of Conduct*, cl 30A.

[32] *Franchising Code of Conduct*, cl 30A(1).

[33] *Franchising Code of Conduct*, cl 30A(2).

[34] *Franchising Code of Conduct*, cl 30A(3).

[35] *Franchising Code of Conduct*, cl 31(1).

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A typical contractual clause for ADR might be in the following form:

Dispute Resolution

1. If a dispute arises out of or in relation to this agreement or its breach, termination, validity or subject matter, a Party must give written notice of the particulars of the dispute to the other Party within three business days, and the Parties must act of good faith and use their best endeavours to settle their dispute through discussions between their representatives appointed for that purpose, within a further seven business days.
2. If the dispute is not resolved within those 10 business days, the Parties must act in good faith and use their best endeavours to settle their dispute by mediation in Australia conducted by a qualified mediator appointed by the Parties or failing agreement, by the Office of the Mediation Adviser, within a further 28 days.
3. If the dispute has not been settled through mediation within those 28 days (or such other period as agreed between the Parties in writing) the dispute must be referred for arbitration in Sydney or such other place as the parties agree, by a single arbitrator appointed by the Parties or failing agreement, by an arbitrator (being either junior or senior counsel practicing in commercial law) appointed by the President of the NSW Bar Association.
4. The arbitrator must not be the same person as the mediator, and if the arbitrator so decides, the arbitration will be conducted on the basis of documents, unsworn witness statements and written submission submitted by the Parties together with a statement of the final negotiated position of each Party. The arbitrator will read the documents submitted by each party and make an award which is final, binding on and confidential to the Parties.
5. The Parties will each pay an equal proportion of the cost of the mediator and the arbitrator, and their own costs and disbursements.
6. A Party must not commence court proceedings before exhausting the dispute resolution procedures in the preceding clauses.

Law and jurisdiction

7. This agreement is governed by the law of New South Wales and any proceedings are to be brought in the courts at Sydney.

This form of clause is drafted to cover most disputes between the franchisor and franchisee which either arise out of, or in relation to, the franchise agreement. Consistently with the Franchise Code, and most such clauses, it requires written notice to be given of the particulars of the dispute.

The clause is a three-part escalating clause which invokes a procedure requiring inter-party discussion with best endeavours, followed by mediation, and finishing with arbitration with the decision of the arbitrator being final and binding on the parties. The advantage of the arbitration clause is that it brings finality to the dispute, and ensures outcome confidentiality for the parties.[36]

The law and jurisdiction clause is drafted to ensure that if there are any court proceedings, they are brought in the courts at the nominated place (eg in Sydney).

A party seeking to enforce this procedure will be entitled to bring an application for a stay of any court proceedings commenced by another party.

Court rules

The courts support the mediation process which has been established as an important ADR procedure:

> [T]he adoption of mediation by the courts is a critical point in the development of dispute resolution processes and we are keen to provide a forum where the wider policy issues involved in court annexed mediation can be critically and constructively examined.[37]

Most, but not all, Australian courts have rules enabling them to refer the parties to compulsory mediation – even if the parties do not consent – before permitting the dispute to proceed.

[36] The advantage for the franchisor is that there is no precedent for other franchisees, and the advantage for the franchisee is that the franchisor does not have to worry about a precedent for other franchisees.

[37] Professor Helen Gamble, Head of the Centre for Court Policy and Administration in the Faculty of Law, University of Wollongong (NSW), quoted in (1994) 5(1) *LEADR Brief July* 4.

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The Federal Court of Australia has power[38] to direct the parties to mediation even if they do not both consent,[39] with the same power for the Federal Magistrates Court.[40] The Federal Court Rules provide for reference to mediation, adjournment of court proceedings for mediation, nomination of mediator, conduct of the mediation and termination of the mediation.[41]

In New South Wales, all courts have the power[42] to refer the whole or any part of the proceedings to mediation with or without the consent of the parties, by a mediator agreed by the parties or appointed by the court. The court is required to make its own assessment of the utility of mediation and has regard to the chance of resolving the dispute and avoiding the tangible and intangible costs, delay, and uncertainty likely to be associated with the dispute proceeding to a final hearing for determination.[43]

In New South Wales (but not the federal jurisdiction), the party representatives who must attend the mediation are prescribed,[44] as is the extent of their authority, and there is a statutory obligation on the parties directed by the court to attend a mediation to act in good faith.[45]

Documents used for the mediation

There are no prescribed forms for a mediation under the Franchise Code, but the OMA provides the mediator with a form of Agreement for Appointment of Mediator which is signed by the parties and the mediator no later than the commencement of the mediation. The agreement covers the following matters:

- the principles of the franchising code of conduct apply;
- anything the mediator says is not binding;
- private meetings with one side can be held with the mediator;
- the parties are required to attempt to resolve the dispute in the mediation and to instruct their advisers accordingly;
- each party must be represented by at least one persons with full authority to settle the dispute within any range that can reasonably be anticipated, and must inform the mediator immediately if they do not have that authority;
- confidentiality is the foundation of the mediation process;
  - all information disclosed to the mediator in private is confidential unless the party states otherwise;
  - the parties and the mediator are prohibited from disclosing any information or document given to them during the mediation, to third parties (other than the party's lawyer or accountant), unless required by law to make such a disclosure;
  - third parties who attend with a party are required to sign a confidentiality agreement;
  - this does not prevent a party or the mediator reporting to the Mediation Adviser in a form determined by the Mediation Adviser;

[38] The *Federal Court of Australia Act 1976* (Cth), s 53A and *Federal Court Rules* (Cth), O 72 provide procedural guidance for mediation.

[39] *Kilthistle No 6 Pty Ltd (receiver and manager appointed) and Ammrad Pty Ltd t/a Lloyds Transportable Homes and Better Look Homes Pty Ltd v Austwide Homes Pty Ltd* [1997] FCA 1383; *ACCC v Lux Pty Ltd* [2001] FCA 600; *Lone Star Steakhouse & Saloon Inc v Zurcas* [2000] FCA 29.

[40] *Federal Magistrates Act 1999* (Cth), ss 21, 34; *Federal Magistrates Court Rules 2001* (Cth), rr 27.01-27.06.

[41] *Federal Court Rules* (Cth), O 72, rr 1-8.

[42] See the *Civil Procedure Act 2005* (NSW), Pt 4, ss 25-34. See the *Uniform Civil Procedure Rules 2005* (NSW), Pt 20, Div 1, rr 20.1-20.7 and Practice Note SC, Gen 6 which sets out the Joint Protocol and see paras 19-35. Information on court references to mediation including the form for referral to mediation are set out on the Supreme Court of New South Wales website: http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_mediation viewed 23 April 2008.

[43] See *Ritchie's Uniform Civil Procedure* (looseleaf service, Lexis Nexis Butterworths) at [26.10].

[44] *Uniform Civil Procedure Rules 2005* (NSW), r 20.6 requires attendance by each party, or an officer of a corporation, or an officer of an insurer, and all are required to have authority to settle the proceedings. A party is also entitled to be legally represented.

[45] *Civil Procedure Act 2005* (NSW), s 27. The absence of this formal obligation is one of the deficiencies in the Code.

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- – everything prepared, said and written for and during the mediation and to the Mediation Adviser is privileged and cannot be disclosed or subject to a subpoena in court proceedings;
- the settlement agreement can be enforced by court proceedings;
  - – a party calling the mediator to give evidence of the settlement agreement indemnifies the mediator for legal costs;
- the mediator can terminate the mediation at any time after consulting the parties, but must terminate on the request of a party if nor resolution is reached after 30 days from the start of the mediation;
- the mediator and the Mediation Adviser are not liable to a party for any statement, act or omission in assisting the parties unless the act or omission is fraudulent;
- the parties indemnify the mediator and the Mediation Adviser against any claim for any statement, act or omission in assisting the parties to resolve their dispute unless the act or omission is fraudulent; and
- the parties pay the mediator's fees and disbursements equally (in advance).

Advantages of mediation

A significant advantage for the parties in a franchise dispute is the private and confidential nature of the mediation process and its outcome, the absence of a precedent and publicity by comparison to the very public nature of a dispute heard and determined by a court, which may establish a precedent and agitate other franchisee complaints against the franchisor.[46]

Other advantages include:

- Just: the parties compromise their dispute to achieve a mutually agreed outcome; and no determination imposed by a court in favour of one party and against the other.
- Quick: the parties set the timetable for the mediation process; no competition for limited court resources; and finality, without the uncertainty and delay of a judicial appeal process.
- Cheap: parties share the mediation cost and pay their own costs; and unlike court proceedings there is no requirement for the loser to pay the winner's legal costs.

The Australian experience

Franchising represents a small but significant proportion of small business in Australia.

In 2007, there were over 850 franchise systems in Australia[47] with about 61,860 Australian small businesses involved in franchising, made up of 56,200 franchisees and 5,660 company-owned outlets. This represented about 5.5% of 1.1 million small businesses in Australia. By comparison, in the United States, about 3.2% of small businesses are franchises.[48]

Franchising has grown strongly since 2002 and represents a growing proportion of GDP:

Year	New franchises	Growth rate%	GDP contribution
2002	700*	21 (2002-2004)	
2004	850	15.3	12% ($80 billion)
2005			14% ($125 billion)
2006	960**	13 (2004-2006)	

[46] A constant concern for franchisors at mediation is that the outcome will be disclosed despite the confidentiality obligation, and that other franchisees are awaiting the outcome before agitating further disputes. The mediator should address this issue in opening remarks emphasising the confidentiality obligation and the adverse consequences of a breach of that confidentiality, and repeating as necessary during the negotiations. However, there is no formal recourse for a breach of confidentiality in the mediation Code and this is another deficiency.

[47] Mybusiness: e news, *Franchise Review Special* (September 2007) p 50.

[48] *Australian Financial Review* (20 January 2005) p 44.

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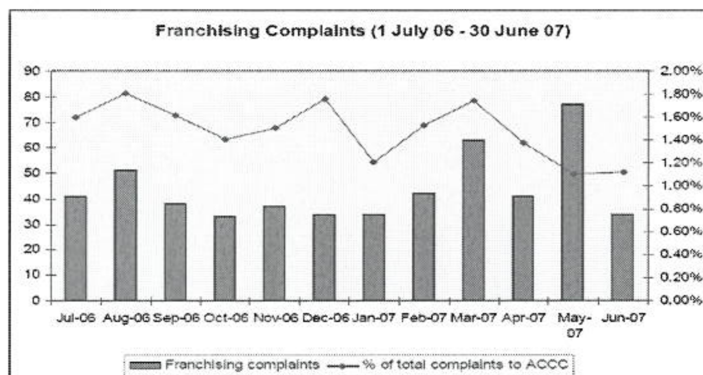
Year	New franchises	Growth rate%	GDP contribution
* Griffith University Franchising Australia Survey, *Australian Financial Review* (20 January 2005) p 44. ** Griffith University Franchising Australia Survey, *Australian Financial Review* (October 2006).			

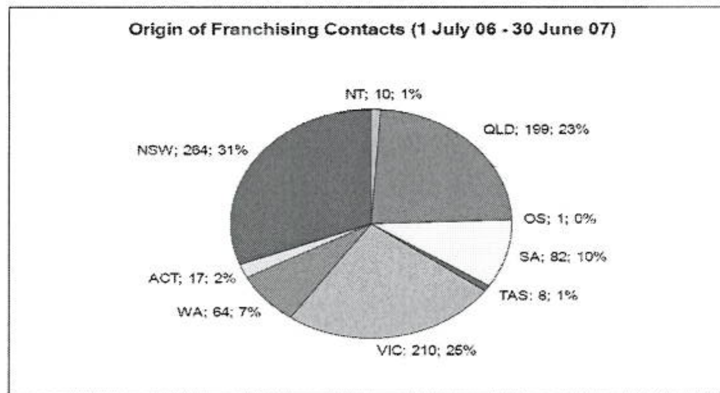
It has been predicted to be the predominant form of sales distribution by 2012, though this may be optimistic. By 2006, franchising represented 2.5% of Australian employment, compared to about 3% in the United States but only about 0.55% in the United Kingdom.

FRANCHISE DISPUTES

The Australian Competition and Consumer Commission (ACCC) recorded 525 franchise complaints in the 12 months to 30 June 2007,[49] shown in the following chart:[50]



The breakdown between States was recorded as follows:[51]



As might be expected, the number of inquiries to the Office of the Mediation Adviser has increased with the growth in franchise activity since 1999 with most inquiries from New South Wales, Victoria and Queensland:

[49] Martin J, *ACCC Report Card on Franchising Issues*, Presented at the Franchising Council of Australia Legal Symposium (Melbourne, 11 October 2007).

[50] Martin, n 49, p 2, Chart 2. Martin notes that the increase in franchise complaints in March and May 2007 were largely due to inquiries arising from review of the Code and expected amendments.

[51] Martin, n 49, p 3, Chart 3.

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Year	No of inquiries	Mediator appointed	%
1999	176	53	30
2000	286	83	29
2001	260	90	35
2002	308	67	22
2003	368	77	21
2004	351	124	35
2005	448	140	31
2006	340	133	39
Totals	2537	767	30
All figures from the Office of the Mediation Adviser			

The request for mediation was made mostly by franchisees (65%) and less frequently by the franchisor (35%), with franchisor requests for mediation increasing from about 10-15% in the early years. In 2004, about 4% of franchisees had a dispute with their franchisor.

The ACCC reports that in its experience, franchising complaints usually raise the following issues:[52]

- unconscionable conduct in business transactions (s 51AC);
- misleading and deceptive conduct and or misrepresentations (ss 52-53); and
- disputed terms of the franchise agreement,

and generally involve:

- scams, frauds or outright exploitation;[53]
- issues arising from structural market pressures;[54] and
- poor relationship management.[55]

The issues raised in mediation are wide and mediations rarely involve a single issue: lack of system compliance (55%); communication problems (21%); misrepresentation (18%); and profitability (18%). However, some 70% of disputes were resolved once a Notice of Dispute was issued, and only 30% of initial inquiries have been referred for mediation. Mediation has a 74% settlement success rate.

The Office of the Mediation Adviser has about 140 mediators on its national panel facilitating local mediations. Franchisors are usually represented by a decision maker, in-house counsel,[56] or external lawyers; franchisees by themselves, or by directors with or without[57] advisers (lawyers and or accountants).

[52] Martin, n 49, p 3.

[53] Martin, n 49, p 4, involving misleading or deceptive conduct or willfully exploiting superior bargaining position. Complaints included business scams, harsh and oppressive behavior, and "churning" franchisees.

[54] Martin, n 49. Arises when the provision of goods or services is not working well with supply and demand in a competitive market. Martin notes that the currently tight labour market has increased structural pressure in middle tier and lager franchise systems experiencing systemic structural issues.

[55] Martin, n 49. This usually involves poor communication and manner of response, including reluctance to acknowledge the legitimacy of concerns, or dealing with a complaint as a personal criticism.

[56] Representation by an in-house lawyer is one of the problem areas discussed later in this article.

[57] A franchisee (and rarely the franchisor) attending mediation unassisted by professional representation is disadvantaged as invariably the presentation with be ad hoc, unstructured and unpersuasive, with no chronology, no collated documents, no summaries or vouchers to support a claim for any alleged losses.

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Deficiencies and problems

In the current mediation process, there are a number of deficiencies:

- franchisor Issues a formal default notice prior to mediation;
- no formal requirement for parties to act in good faith;
- no sanction for the absence of good faith;
- no sanction for the absence of authority;
- no sanction for breach of confidentiality; and
- no post-mediation process,

and problems:

- inequality of negotiating power in favour of the franchisor against the franchisee;
- franchisors without independent advice;
- unrepresented franchisees;
- poor preparation;
- a party attending with limited authority for negotiation; and
- refusal to compromise (usually the franchisor).

Issue of formal default notice prior to mediation

There is an obvious tension and conflict between the franchisor issuing a default notice before a reference to mediation under the Franchise Code, more so as the right to issue a default notice is limited to the franchisor without any equivalent contractual right provided to the franchisee.

The contractual right of the franchisor to serve a written default notice to initiate the termination process places the franchisee at a negotiating disadvantage, and establishes an inequality in the negotiating positions between the franchisor and franchisee, because the franchisor treats the default notice as non-negotiable requiring remedy, and both parties are aware that it initiates a procedure which contains a threat of termination of the agreement and forfeiture of the franchisee's capital.

In this situation, the negotiations between the parties are usually conducted in an environment where the franchisor (who usually issues the notice) adopts a strict or textual construction of the contractual term in dispute.

The solution is to amend the Franchise Code to require the franchisor to complete the mediation process as a precondition to be satisfied before it can issue a default notice, and where a default notice has been issued prior to mediation, to render it void. This has the ameliorating effect of removing the threat of the notice, and requiring the franchisor to re-issue after the mediation, if it is not successful.

Good faith

Good faith has become an element of domestic commercial activities though well known and of long standing in international commerce[58] and equity. One of the problems for good faith in franchising activity arises from the common law approach to good faith where it is regarded as a mere implied term which can be expressly excluded by contract.[59] More recently, good faith has become a subject of statute where it is recognised as an element of unconscionable conduct,[60] but, surprisingly, good faith is not identified as an express requirement under the Franchise Code.

However, the obligation of the parties to act in good faith in a mediation is expressly stated in the court rules in New South Wales:

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[58] Good faith is an express obligation in the *Bills of Exchange Act 1909* (Cth), s 96: "A thing is deemed to be done in good faith, within the meaning of this Act, where it is in fact done honestly, whether it is done negligently or not"; and a presumption of good faith in s 35. See also the *Marine Insurance Act 1909* (Cth), s 23: "A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party." Good faith forbids a concealment of what is known privately by a party to draw the other into the contract, based on the others ignorance and belief to the contrary: *Carter v Boehm* (1766) 3 Burr 1905 at 1910 (Lord Mansfield CJ); it is a mutual requirement and there are no degrees of good faith: *CTI v Oceanus* [1984] 1 Lloyd's Rep 476 at 525 (Stephenson LJ).

[59] Dixon B, "Can the Common Law Obligation of Good Faith be Contractually Excluded?" (2007) 35 ABLR 110.

[60] TPA, s 51AC(3)(k) having regard to the extent to which the parties acted in good faith in a business transaction.

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> It is the duty of each party to proceedings that have been referred for mediation to participate, in good faith, in the mediation.[61]

The agreement for the appointment of a mediator partially approaches this issue, but not comprehensively. The solution is for the Franchise Code to adopt the express statement of obligation in the New South Wales Court Rules.

In addition, a sanction by which the mediator can refer the matter of an absence of good faith to a franchise panel judge requiring the corporate officer to explain or justify the position taken. The availability of this sanction is likely to have a remedial effect.

Authority of representatives limited or subject to policy

There are times when a corporate party attends mediation by an officer who has to report to the company board, and to explain the outcome. This is more likely to be a problem for the franchisor, as the officer does not "own" the dispute or the resolution in the same sense as the franchisee as he or she is usually not directly or personally involved in the circumstances of the dispute. Further, the representative has to report to a supervisor or the board of the corporate franchisor. This poses a number of problems for resolving a dispute at mediation:

Limited authority

The corporate negotiator may have limited rather than full authority, with the authority being too narrow to encompass a settlement range "that can reasonably be anticipated", despite the clear statement in the OMA mediation agreement at cl 6:

> The Parties shall attend or be represented before the Mediator by persons with full authority to settle the Dispute within any range that can reasonably be anticipated. The Parties agree to inform the Mediator immediately should they not have authority to settle within any range that can reasonably be anticipated.

In the author's experience, disclosure of limited authority is never revealed to the mediator, and the limitation on authority does not become apparent until the offers and counter-offers are being made, at which stage the officer reveals that he or she has to contact someone else in the company, who then is not immediately available, or worse still, is absent overseas and not contactable.

Franchisor policy

This arises where the franchisor has a policy about the dispute resolution process which does not involve compromise at mediation, and where the corporate officer has no authority to compromise inconsistent with the franchisor's policy.[62]

The solution for this deficiency is to make it clear in the Franchise Code that a representative must attend with full and unlimited authority to compromise and reach an agreement within the full range of possibilities that can be reasonably expected.[63]

This requirement should also be supported by a sanction, by which the mediator can refer the absence of authority to a franchise panel judge for the corporation to explain or justify the absence of full authority. The availability of this sanction is likely to have a remedial effect, and is unlikely to require this recourse.

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[61] *Civil Procedure Act 2005* (NSW), s 27.

[62] The author was surprised to hear this explanation offered by a corporate officer who explained that the franchisor had a certain policy about compromise and the resolution under discussion was inconsistent with that policy and could not be considered. On another occasion, the franchisor's representative advises its policy was never to make a payment to the franchisee unless the franchisor was in the wrong. This latter policy raises two issues: how is fault defined, and is such a policy contrary to the good faith obligation? The franchisor's adoption of a particular policy position does not satisfy any legitimate negotiating strategy for a mediation and is not a pre-emptory concession strategy, as obviously it involves no concession, but a dogmatically held position.

[63] That does not preclude the development of a negotiating strategy, but it is the absence of a willingness to compromise to achieve an outcome in franchise mediations which should be of concern.

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Reporting to persons who were not present at the mediation

This arises where the corporate negotiator acts as a mere delegate and has to report to persons who were not present at the mediation, and justify the outcome, possibly be subject to personal criticism for being a poor negotiator, being too weak, giving away too much by way of compromise, making an agreement which members of the board may not like.

Breach of confidentiality

Franchisor representatives sometimes raise the uncertain effect of the franchisee's promise to observe confidentiality as a bar to a negotiated outcome, often expressed as a reluctance to create a "precedent" which will be pursued by other franchisees once they become aware of the result. The franchisor's allegation is sometimes coupled with an allegation that the promise is of no value as there is no apparent sanction, or that the promise is more likely to be honoured in the breach than observed.

This is a difficult issue as the allegation is easily made, and the promise of confidentiality is easily countered with derision, even though a franchisee competently represented will be absolutely clear about what the obligation involves.

Inequality of negotiating power

Inequality in the negotiating power between the franchisor and franchisee is recognised as unconscionable conduct in equity and by statute.[64] It is not limited in time, and can arise during pre-contract negotiations, continue in the conduct between the parties in performance of the contract, and during mediation negotiations.

This is difficult to ameliorate but strengthening the good faith obligation of the parties, with a clearly stated obligation to compromise seems to be the answer, if the sanction is a "please explain" to the court. However, the threat to confidentiality of the mediation process seems to weigh against sanction, other than perhaps the mediator reporting to the court that in his or her opinion there was an absence of good faith by one or other of the parties at the mediation. This does not seem to be practical.

Franchisor without independent advice

This arises where the franchisor acts through its in-house lawyer, whose faces the direct conflict between duty owed as an employee to his or her employer and independent professional duty owed to the mediation process. In the author's experience, this is where the application of the franchisor's "policy" towards compromise and mediation resolution is most likely to arise as the employee lawyer is more unlikely to give independent advice to his or her employer than an external lawyer.

Unrepresented franchisees

Unrepresented franchisees at a mediation are disadvantaged almost without exception. In the author's experience they are not sufficiently removed from the process, they are likely to be unfamiliar with the process, have little or no knowledge of effective preparation, strategy or persuasion. They are unfamiliar with negotiating concepts and are less likely to get a result equivalent to that which they would if they were represented.

There is nothing that can be done about this in the Franchise Code as it is a choice that parties are free to make. However, the OMA should consider establishing a franchise mediation pro bono scheme supported by the legal profession through the Bar Association and the Law Society of the relevant State.[65]

[64] See TPA, s 51AC(2)(a): "the relative strengths of the bargaining positions of the supplier and the business consumer; (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer …; (k) the extent to which the supplier and the business consumer acted in good faith."

[65] Pro bono schemes already exist but it should be possible to obtain support for a franchise mediation scheme.

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Inadequate preparation

Inadequate preparation arises through a lack of understanding of the mediation process, and is more likely to disadvantage a franchisee as the franchisor is usually experienced in the mediation process. Inadequate preparation by a franchisee includes, at the worst extreme, uncertainty about what the franchisee wants to achieve at mediation.

Ideally, parties should prepare for mediation with a list of the issues for resolution, the outcomes sought (with second and third positions prepared for the negotiations) a chronology of relevant events with a cross reference to supporting documents.

Refusal to compromise

Compromise involves a settlement of differences by mutual concession.[66]

A refusal to compromise is a difficult issue with no clear solution. On one level, it involves a refusal to participate in the mediation process at all, which is easily recognised. Less easily recognised is the conduct of a party attending mediation but frustrating the mediation process by refusing to compromise. A refusal to compromise any issue at a mediation constitutes an absence of good faith and arguably amounts to unconscionable conduct.

The primary solution is for a mediator to adopt a robust position and remind the parties on the obligation to compromise, but with recourse, by allowing the mediator to report to the OMA and a court (where proceedings are on foot) that, in his or her opinion, a party did not act in good faith at the mediation as they refused to compromise on any or on a particular issue.

POST-MEDIATION PROCESS

Under the Franchise Code the ADR process ends with mediation, and leaves the parties to seek determination of the dispute by the court, or possibly by arbitration if there is a contractual arbitration clause.However, if the ACCC has a complaint after unsuccessful mediation it will communicate with the franchisee and franchisor and will adopt a whole system approach to identify and address any systemic issues.[67]

Apart from an ACCC investigation and action after an unsuccessful mediation the only other recourse is for the parties to commence proceedings in the court for judicial determination.

This raises the question of whether it will be useful for the courts to have a franchise panel and docket system where the dispute is listed before a franchise panel judge or magistrate who can supervise the parties to the mediation process by providing recourse for breach of the mediation obligations under the Franchise Code, and case manage proceedings, including further compulsory mediation.

THE FUTURE

There is no doubt that the current procedure has worked well and has a high success rate, but there is always room for improvement.

In the author's opinion, the Franchise Code should include an express obligation for the parties to a Franchise Code mediation to act in good faith and to compromise their disputes.

[66] *The Macquarie Dictionary* (Macquarie Library Pty Ltd, 1981).

[67] Martin, n 49, p 5.

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