VICTORIAN SMALL BUSINESS COMMISSIONER

SUBMISSION TO THE REVIEW OF THE FRANCHISING CODE OF CONDUCT

February 2013

Introduction

The Victorian Small Business Commissioner (VSBC) welcomes the Review of the Franchising Code and the opportunity to make a submission to the Review. The VSBC was established under the *Small Business Commissioner Act* 2003 (Vic) ('SBC Act') as an independent office to enhance a fair and competitive operating environment for small business. Since 2003 the VSBC has received over 11,000 applications for assistance from businesses to resolve disputes with other businesses, or with government. Some of these requests have been from franchisees or franchisors. The total amount claimed in dispute in applications received by the VSBC since 2003 exceeds $1 billion.

The success of the VSBC has led to the establishment of Commissioners in NSW, SA and WA over the past twelve months, and an Australian Small Business Commissioner was established in January 2013.

This Submission:

- Provides background to the jurisdiction of the VSBC, services provided, and activity data;
- Profiles matters handled by the VSBC relating to franchisees and/ or franchisors;
- Comments on some of the issues raised in the Discussion Paper.

The VSBC previously provided a submission to the Expert Panel appointed to advise on strengthening the Franchising Code of Conduct and unconscionable conduct provisions of the Trade Practices Act 1974[1]. This submission focussed on improving parties' behaviours and business conduct in franchise relationships. These themes are of continuing relevance to the current Review.

[1] VSBC Submission, January 2010. Available at sbc.vic.gov.au.

Background to the VSBC

Jurisdiction

The VSBC operates under four pieces of Victorian legislation:

- *Small Business Commissioner Act* 2003 ('SBC Act')
- *Retail Leases Act* 2003 ('RL Act')
- *Owner Drivers and Forestry Contractors Act* 2005 ('ODFC Act')
- *Farm Debt Mediation Act* 2011 ('FDM Act')

The VSBC provides dispute resolution services under all four Acts. In the latter three Acts, disputes must first be referred to the VSBC for attempted resolution before a party can progress the dispute to the Victorian Civil and Administrative Tribunal or the Court system (with minor exceptions). In the case of the SBC Act, there is no mandatory referral of disputes to the VSBC, but the dispute resolution services provided by the VSBC can be accessed by any business with a commercial dispute with another business, or government body.

There is no definition of 'small business' in any of the four Acts; the VSBC does not assess the size of a business to determine eligibility for access to the services.

The VSBC has a range of other functions (other than dispute resolution and prevention functions) under the SBC Act. Of most relevance to this Submission are the following functions:

- To make representations to an appropriate person or body regarding unfair market practices;
- To investigate compliance with industry codes;
- To investigate any matter relevant to the Commissioner's functions and powers

From time to time, the VSBC makes representations to appropriate bodies, such as the Australian Competition and Consumer Commission (ACCC). Refer, for instance, to the decision of the Federal Court of Australia in *ACCC v Dukemaster Pty Ltd*.[2] In this case, the Court ordered a landlord to compensate four tenants after it engaged in unconscionable, misleading and deceptive conduct.

[2] [2009] FCA 682.

While the VSBC has not undertaken an investigation into compliance with an industry code (nor is it resourced to do so)[3], it has assisted industry parties develop a draft voluntary Code[4], and has a dispute resolution function under the *Owner Drivers and Forestry Contractors Code of Practice*[5].

In respect of its broader investigative function, the VSBC is currently considering the adverse impact of inadequate notice provisions for planned interruptions under the *Electricity Distribution Code*.

Services

The VSBC provides three levels of services relating to dispute resolution and prevention.

- Information and Education: is provided via telephone and email, presentations, publications and website information.

- Preliminary Assistance: refers to the efforts of Dispute Management Officers in attempting to assist parties to a dispute to resolve the dispute through phone and email shuttle engagement.

- Mediation: services are offered where disputes remain and the parties agree to attend mediation. Mediation is conducted by an independent, expert mediator appointed by the VSBC.

The VSBC charges each party to a mediation $195, for an average 3-4 hour mediation[6]. The mediator cost is subsidised by the VSBC. All other services provided are at no cost to the parties.

Activities and Outcomes

The VSBC receives around 8,000 telephone calls per annum, and in the past two financial years has received in excess of 1,500 applications for assistance with a business dispute. This is consistent with an ever increasing demand for the VSBC services.

Since 2003, over 11,000 applications for assistance have been received by the VSBC. Table 1 shows the profile of disputes by jurisdiction in 2011-12.

[3] However, under section 11 (8) of the *Liquor Control Reform Act 1998*, the VSBC may investigate the compliance by licensees of packaged liquor licences with a code of conduct.
[4] Business Process Improvement – Pallets. Refer VSBC *Annual Report 2011-12*.
[5] Refer *Owner Drivers and Forestry Contractors Regulations 2006*.
[6] $95 per party for ODFC Act disputes. $195 applies for a complete mediation session for FDM Act disputes, regardless of duration on the day

Not all matters progress to mediation. In 2011-12, 25% of applications were resolved through preliminary assistance prior to mediation. Also, the VSBC has no powers to compel parties to attend mediation (although the VSBC has a certificate function under the RL Act, the ODFC Act and the FDM Act). In 2011-12, 25% of applications did not progress to mediation as the respondent party refused to participate, or the respondent party could not be contacted.

TABLE 1: 2011-12 applications for assistance by Act

RL Act	1020
SBC Act	272
ODFC Act	49
FDM Act*	48
TOTAL	**1510**

*Commenced 1 November 2011

Since 2003, the VSBC has consistently achieved a settlement rate at mediation around 80%. Settlement occurs where the parties agree to sign a binding Terms of Settlement.

Franchising matters handled by the VSBC

Disputes relating to franchises may be identified as such in applications lodged with the VSBC, or may not. Accordingly, the reported number of franchising related disputes dealt with by the VSBC may not be a completely accurate representation of actual dispute applications received involving a franchisee and/or a franchisor.

Attachment 1 shows the number of dispute applications relating to a franchisee or franchisor received and recorded as such by the VSBC – on average around 20-30 disputes each year.

There are two main categories of disputes which may relate to a franchisee or franchisor:

Retail Lease disputes. In some cases, the franchisor is the head tenant, and subleases the premises to the franchisee. These disputes may be between the franchisee as tenant and franchisor as head tenant or landlord; or between the franchisee as tenant and the landlord who is not the franchisor. In other cases, the franchisee as tenant leases premises from a landlord, but the franchisor may be involved in the dispute due to the terms of the franchise agreement.

The essence of these disputes relates to Retail Leasing, although the franchising relationship can make the issues more complex. These disputes are mediated under the RL Act.

Some disputes may also arise relating to a franchisor licensing premises to a franchisee. These matters are mediated under the SBC Act, as the RL Act does not apply.

Around 40% of VSBC franchise related disputes are Retail Lease disputes, although the percentages vary from year to year.

Franchise Agreement disputes. These disputes relate to whether or not either party is complying with the terms of the Franchising Agreement, or there is a dispute relating to those terms. As general commercial disputes, these disputes are mediated under the SBC Act.

Further data profiling of disputes involving franchisee/franchisors

The VSBC does not capture detailed data for franchising related disputes as does the Office of the Franchising Mediation Adviser (OFMA). Detailed data on retail lease disputes are captured, of which franchise related disputes are a very small percentage.

Settlement outcomes at mediation involving a franchisee or franchisor are not fundamentally different to those for all mediations – around 80% settlement.

There is no data suggesting franchising dispute mediations vary significantly in duration from other types of mediations, although anecdotally some mediators have suggested that complex franchise disputes would be better scheduled for a full day rather than the usual half day.[7]

Where a dispute is between franchisee and franchisor, around 80% of applicants are franchisees – meaning around 20% of applicants are franchisors. This breakdown reflects well on the independence and expertise of the VSBC in resolving franchising disputes.

During the past two years there have been instances where multiple disputes involve the same franchisor. In one case, over twelve applications were lodged against the same franchisor, which provided commercial cleaning franchises. Almost all applicants were of Chinese background. The VSBC requested a meeting with the franchisor to understand what behaviours or practices were causing this spike in disputes. The franchisor advised that it had deliberately identified the Chinese community through advertising to build its franchise base.

[7] In such cases, the VSBC charges both parties – franchisee and franchisor - $390 each – for a full day mediation.

While franchisees had signed acknowledgements that they had obtained legal advice, and understood what they were signing, it was apparent that in many instances the applicants did not understand the detailed contractual terms of the franchise agreement.

Most of these disputes were about the alleged failure of the franchisor to provide what was understood to be a guaranteed amount of work (and payment) each month, and the failure of the franchisor to return all of the franchisee's ingoing contribution when the franchisee sought to terminate the agreement. In fact the contract terms did not provide a work guarantee, although a cursory glance could have led to this view being formed. Further, the contract detailed the basis on which any amount would be returned to the franchisee in the event of early termination by the franchisee. This example highlights that, no matter the level of disclosure of the details of a franchising agreement, parties may sign a document without clearly understanding all terms. Of course, this is not limited to franchising agreements. In this case, however, the identification of franchisees whose first language was not English may have contributed to the lack of understanding of the terms of the agreement. It is not known what oral representations were made to franchisees prior to entering the agreement, and whether these fully outlined the details of the agreement.

It should be noted that most of these disputes were either resolved prior to mediation, or settled at mediation via the VSBC. As further illustration of the imbalance of power between franchisor and franchisee, the franchisor in this case had sought to reach a settlement with the franchisee on the condition that the franchisee signed an undertaking that it would take no legal action now or in the future against the franchisor, or assist any other franchisee in any activity. It also included an attribution of cost provision. (A copy of the original proposed undertaking is at Attachment 2).

This case also highlights the distinction between the dispute resolution service offered by the VSBC, and an investigation undertaken by the VSBC. Where there appear to be repeated or systemic issues underlying a number of disputes, whether with the same respondent, industry, location or business practice, the VSBC will seek to identify the underlying issues and causes. This may involve writing to the respondent party/ies, requesting meetings, or seeking information.

The aim is to resolve the disputes as well as preventing similar disputes arising. The individual disputes may subsequently be resolved 'as a group', or may still be better addressed through individual mediation, depending on the circumstances.

The above case also demonstrates the seemingly growing number of franchisees of non-English speaking background. This group presents a particular challenge for the franchising sector, in terms of their understanding and due diligence associated with entering into a franchising relationship, and their role in dispute resolution.

Again, anecdotal evidence suggests such franchisees may require additional assistance and/or representation – including legal representation - during mediation processes. It also supports increasing information and education activities directed specifically towards such franchisees, and prospective franchisees (refer also to following discussion).

Issues raised in the Discussion Paper

There are a large number of questions posed in the Discussion Paper. Many request views on whether changes introduced in 2008 and 2010 have been effective. The VSBC is not able to provide evidence to assist in this assessment, given the relatively few franchise-related disputes handled and the lack of detailed data on these disputes. There are relatively few franchise disputes progressing to mediation as required under the Franchising Code (VSBC plus OFMA mediations totalling around 100 – 120 per annum) compared with the large number of active franchise arrangements in Australia. At face value this would appear to suggest that there is relatively little disputation in the franchise sector. However, a question for the Review to consider is whether parties (primarily franchisees) are both aware of and understand the dispute resolution processes in the Code, and if they do, whether they are willing to utilise them. Franchisee and franchisor are 'joined at the hip' in their commercial arrangement for the duration of the franchise, and a franchisee may understandably be unwilling to escalate a complaint if it believes such action may lead to future attitudes or actions by the franchisor which may disadvantage the franchisee's business – notwithstanding the provisions in the Franchising Code and the franchise agreement.

It must be emphasised that the comments in this submission are largely informed by the franchise-related disputes brought to the VSBC. As such, the comments may be influenced by conduct and behaviours which are not reflective of the wider franchising sector.

As indicated above, the VSBC considers it is necessary to re-examine and reinforce information and education activities for franchisees. In this respect, the work undertaken by the ACCC, and associated bodies, is commendable.

With the commencement of the Australian Small Business Commissioner from 1 January 2013, the VSBC queries whether this new Commonwealth initiative should assume greater responsibility in providing information and education services for the franchising sector, possibly in cooperation with the State-based Small Business Commissioners.

The VSBC would like to comment on the following matters raised in the Discussion Paper:

Attribution of legal costs

The VSBC draws to the attention of the Review the *Farm Debt Mediation Act* 2011 (Vic) ('FDM Act'). The Purpose of the FDM Act is 'to provide for the efficient and equitable resolution of farm debt disputes by requiring a creditor to provide a farmer with the option to mediate before taking possession of property or other enforcement action under a farm mortgage'[8]. In other words, the intent is to attempt to resolve a dispute through mediation rather than through litigation. The mandatory mediation requirements of the Franchising Code would appear to have similar intentions.

The VSBC provides the mediation service under the FDM Act.

On two occasions, the VSBC has been alerted to the fact that a creditor had passed on to the farmer its legal costs associated with compliance with the FDM Act. These attributions were based on provisions in the financial facility agreement between the creditor and farmer.

A provision of the FDM Act[9] voids any provision of an agreement or instrument which seeks to avoid, modify, or restrict the operation of the FDM Act, or seeks to indemnify a creditor for any loss or liability arising under the FDM Act. The VSBC wrote to both creditors, and successfully obtained reversals of these particular transactions, but also obtained the creditors' agreement not to attribute their legal costs of complying with the FDM Act in other instances. The VSBC also wrote to associations representing creditors and the Law Institute of Victoria about this issue.

While the specific provisions of section 29 of the FDM Act were important in securing these undertakings from creditors, the principle behind these provisions is important to understand. To enable a fair and equitable mediation process to occur, it is unreasonable and unacceptable if one party's costs of initiating, participating and concluding the mediation are at the other's expense. Such an inequality may encourage the indemnified party to over utilise legal resources, as there is no or lowered cost disincentive to do so. On the other hand, the imbalance (if known to the other party) will encourage actions or decisions by the disadvantaged party to minimise the likely use of legal resources by the indemnified party – which may extend to doing what the other party wants or trying to resolve matters as quickly as possible without full consideration of consequences.

[8] FDM Act s.1
[9] FDM Act s.29

While in the case of the FDM Act the amount of debt owed by most farmers is a much larger amount than any creditor legal fees likely to be incurred, the attribution of legal costs associated with the dispute resolution process is not consistent with the fair and equitable carriage of a mediation process or the intent of the FDM Act.

The VSBC has seen a number of franchise agreements which provide for the attribution of legal costs by the franchisor for the dispute resolution process required by the Code and any enforcement actions arising. While disclosing this attribution of costs informs the aspiring franchisee of its existence, disclosure does nothing to address the imbalance created in the (mandatory) mediation process as described above when a dispute arises. Awareness of the provision may make a franchisee reluctant to raise a complaint or dispute. Any dispute raised will suffer from the behavioural incentives and disincentives described above. From VSBC experience, the amount in dispute (or the issue in dispute) is also of much lower quantum than farm debt disputes, which are typically in the $millions.

It could be argued that attribution of costs is a means by which trivial franchise disputes do not get raised. Two points in response are:

- Successful business relationships[10] depend heavily on open, effective and good faith communication between businesses, and this must surely be particularly the case in a franchise relationship. Anything which stifles effective and honest communication between franchise partners cannot be good for the franchise.
- While mediation is a low cost dispute resolution process, it is not costless. Parties are required to pay an amount toward mediation, there is the time required to prepare and attend mediation, and there are costs if representation is required.

The Review should consider whether, in the interests of fair and equitable (and mandatory) dispute resolution procedures under the Code, attribution of costs by the franchisor should be allowed under the Code.

Attribution of legal cost clauses usually also apply to litigation and enforcement action taken as a result of a breach. The appropriateness of such clauses in franchise agreements also warrants attention. If the aim of the Code is to have quick, low cost dispute resolution processes, a dispute not resolved at mediation should ideally progress to a non-cost jurisdiction for adjudication (for example, the Victorian Civil and Administrative Tribunal in Victoria), requiring both parties to pay their own costs. In such a jurisdiction a contractual provision requiring the franchisee to indemnify the franchisor its legal costs of the action makes little sense.

[10] The Review is referred to research undertaken by the VSBC in 2007: 'Forming and Maintaining Winning Business Relationships' which highlights the seven key characteristics of successful business relationships. Two of these are Communication and Pre-Agreed Dispute Resolution processes. The Report is available at sbc.vic.gov.au

Alternatively, if the dispute progresses to the Court system, surely it is up to the Court to determine if the claim is valid, and consider costs on application. Again, a contractual term requiring the franchisee to bear the franchisor's legal costs makes little sense.

Attribution of legal fee clauses in franchise agreements for enforcement action would appear to have the primary objective of preventing if not strongly discouraging a franchisee from challenging any alleged breach, and essentially leaves the judgement of whether a breach has occurred with the franchisor.

Unilateral variation clauses

The nature of the franchise relationship is such that there are few other commercial relationships where parties to the agreement are so closely bound to one another. Commercial leases have similarities for the duration of the lease, but do not have the alignment and interdependence of the business operations which franchises have. Franchisees in the main, commit to not only paying significant entry costs (franchise purchase fees) but also ongoing royalty and marketing payments, and compliance with a substantial range of transaction and conduct requirements. Assuming franchisees fully understand the explicit commercial terms of the franchise they enter into, the inclusion of a unilateral variation clause in favour of the franchisor, albeit with a period of notice before such changes take effect, adds enormous uncertainty to the commercial terms presented in disclosure.

While disclosure of such a term is clearly better than non-disclosure, particularly where the disclosure identifies areas where unilateral variation may occur (and has occurred in the past), such terms make it very difficult for a potential franchisee to assess the likely commercial impact and risk arising compared with the known commercial terms at contract execution. If a franchisor subsequently makes a variation which was not specified in disclosure, franchisees may be unwilling to object for reasons noted elsewhere, but particularly where attribution of legal fees provisions apply.

The VSBC understands that the intellectual property, systems and concepts of a franchise belong to the franchisor, it invites franchisees to participate on its terms, and it may need to vary terms for the betterment of the overall franchise. The only protection to the franchisee is the assumption/expectation that such variations made by the franchisor are for the betterment of the franchise system overall. This guarantees net benefit to the franchisor, but does not necessarily guarantee net benefit to the individual franchisee. In most if not all franchise agreements seen by the VSBC with unilateral variation clauses, there is no provision for a franchise to object to or reject the change, nor opt out of the franchise on reasonable terms.

To the extent that the unilateral variation provisions enable variation to an individual franchisee's agreement (rather than all franchisee agreements), the commercial risks to an individual franchisee are amplified.

The challenge for the Review is to assess how a franchisor's rights can be balanced against an individual franchisee's commercial interests and risks which may be worsened as a result of a unilateral variation by the franchisor during the term of the franchise. To the extent the variation disadvantages an individual franchisee, the ability of the franchisee to end the arrangement by selling the franchise may be reduced if there is a lower value of the franchise.

The Review would be aware that the Australian Consumer Law incorporates provisions for unfair contract terms in standard form consumer contracts, and that such terms can be declared void. Unilateral (one-way) variation clauses are typically cited as an example of such unfair contract terms.

Unfair contract terms under the Australian Consumer Law do not extend to business transactions. The Review needs to consider whether the nature of a franchise arrangement is significantly different from other business commercial contracts and if so, whether this warrants unilateral variation clauses (or some subset) being considered void. Types of variations could be identified to consider whether they should or should not be void. For example, operational changes and conduct requirements could be considered necessary to enhance the overall franchise value, whereas unilateral reduction of a franchisee's territory could be seen as commercially disadvantaging that franchisee. The difficulty of categorising potential variations is not underestimated.

Disclosure

The primary role of the VSBC is dealing with commercial disputes between businesses. In franchising and retail lease disputes, alleged non-disclosure (by franchisor and landlord respectively) is a common theme. Of course, the VSBC does not hear about the many franchise and retail lease arrangements where there are no disputes and there is clear and transparent disclosure.

The aim of disclosure is that the franchisee (or tenant) fully understands what they are signing up for – the obligations, the commercial requirements, the risks, the work flows, etc. The VSBC has seen many franchise agreements and disclosure statements which are highly complex, legalistic, and difficult to understand quickly the commercial elements of the agreement. Many of the franchise disputes brought to the VSBC involve terms of the agreement not being properly understood, despite disclosure, due to the complexity of the documentation.

Often the franchisee claims that representations made were inconsistent with the terms of the franchise agreement, once those terms have been explained. In many instances, this confusion is exacerbated by a desire by the aspiring franchisee to 'buy a job' which clouds the willingness to analyse objectively the commercial terms and risks or to make sure that expectations match the contractual reality.

Continuing information and education activities, under the auspices of the Australian Small Business Commissioner in cooperation with State based Small Business Commissioners, would also assist both parties here.

Many franchisee complainants to the VSBC want to exit the franchise (or have exited the franchise) but consider the franchisor should pay them back their full entry payment, despite the agreement providing for retention of specified amounts or percentages on early termination. Such arguments inevitably involve allegations of misrepresentation or breaches of contract terms (e.g. provision of a level of work per month). The former are difficult to substantiate, while breach of terms usually concludes in the franchisor's favour, as the franchisor knows the contractual terms in detail while the franchisee does not. More generally, the franchise agreements seen by the VSBC rarely allow early termination by a franchisee without substantial commercial costs. Such arrangements need to be clearly stated in any disclosure document.

More disclosure is better than less, but the volume, complexity and legality of many disclosure documents make the achievement of the objective of full understanding difficult. The Review could consider whether there are particular types of information to be disclosed which warrant specific attention or form. For example, the commercial obligations of the franchisee should be clearly and simply explained in one section, possibly with a simple example. A section specifically on 'Exiting the Franchise' – and the commercial consequences, could also be highlighted. This would make clear that early termination has commercial consequences; there is no obligation on the franchisor to offer a further term once the current franchise term ends; and a sale of the franchise may occur subject to whatever conditions apply.

It may also be desirable for regular research to be undertaken of the correlation between disclosure and franchisee understanding. Regularly monitoring new or recent franchisees' understanding of the terms of their franchise would enable improvement to be made to any prescribed disclosure obligations.

Disclosure and Leases

In many franchise relationships, there is the significant issue of the franchisee's tenure of premises and whether franchisees are adequately informed of the nature of the relationship that governs their tenure of premises, and applicable laws.

There are four possible arrangements regarding franchisee premises:

- Franchisee leases premises from a landlord (non-franchisor)
- Franchisor leases premises then subleases to franchisee
- Franchisor leases or owns premises then licences to franchisee
- Franchise owns premises then leases to franchisee

In the first case, the lease is between the franchisee and the landlord. The RL Act (and similar legislation in other jurisdictions) will apply. The franchisee as lessee raises any lease dispute directly with the landlord. The franchisor's influence and control over choice of premises, fit-out, etc. may impact on the lease arrangement. For example, the fit-out and signage required by the franchisor may not meet the approval of the landlord, leaving the franchisee in a difficult situation. Any proposed lease in these circumstances requires the franchisee to be clear on the requirements of the franchisor and the requirements of the landlord, and special conditions included in the lease to ensure obligations will be met. The duration of the lease should also be given careful consideration by the franchisee, to avoid finding itself with a franchise but looking for new premises and fit-out, or with premises but no franchise business.

In the second case, the head lease is between the franchisor and landlord. Again the RL Act will apply, both between franchisor and landlord and between franchisee and franchisor. The franchisor can be sure that the premises and conditions for fit-out, signage, etc. are met. The problem for the franchisee is that its sublease is with the franchisor and not the landlord. The franchisor may have little interest in pursuing any franchisee complaints with the landlord, nor in questioning any costs from the landlord which get passed through to the franchisee.

The third case is a variant of the second, with the franchisee occupying the premises under a licence. A licence does not provide exclusive possession as does a sublease. This means that the franchisor can move the franchisee to alternative premises if it chooses. However, the RL Act does not apply to (genuine) licence agreements, and commercial rights and obligations under a licence can be substantially different to 'typical' retail lease provisions.

The fourth case is the same as the first, with the franchisor being the landlord. This removes any likelihood that that landlords' interests are not aligned with the franchisors' (e.g. signage).

It is important that a prospective franchisee understands clearly the arrangements to apply regarding premises, as rights and obligations of all parties to the lease or licence of premises can vary significantly. The relationship between franchise obligations and lease or licence obligations needs to be clear.

This is another area of disclosed information that should be clearly and simply identified in any documentation, the application (or non-application) of the RL Act (or equivalent) should be made explicit, and the franchisee should be directed to advice regarding rights and obligations under that Act.

In all cases above, franchisees should also understand the inter-connectedness between selling the franchise and assigning leased premises to the incoming franchisee. Landlord agreement to assigning a lease is not guaranteed. Equally the franchisor will typically have some rights to refuse the sale of a franchise, based on its assessment of the proposed franchisee. Franchisees need to understand that neither approval is guaranteed, nor does one guarantee the other.

Good faith

As the Discussion Paper notes, the scope and content of the duty in the unwritten law to act in good faith is uncertain, and franchisors and franchisees are already subject to over-arching statutory obligations relating to fair conduct. While there may be benefit in enshrining a duty to act in good faith in relation to conduct at mediation or another appropriate form of dispute resolution (see comments below), it is difficult to see in practice what benefit a specific obligation to act in good faith across the Code can bring having regard to the extent to which a breach of any such duty might be proven or provide a basis for a cause of action or enforcement.

Enforcement

The Discussion Paper notes that while there are no offence provisions in the Franchising Code, actions can be taken where there are breaches of the Competition and Consumer Act (CCA), specifically regarding misleading and deceptive conduct, misrepresentations and unconscionable conduct. Criminal actions need to be taken by the ACCC, while both the ACCC or the aggrieved party may take civil actions. In practice, few franchising-related matters have been litigated by the ACCC, and equally few unconscionable conduct matters generally have successfully been pursued. Misleading and deceptive conduct and misrepresentation cases require compelling evidence of the alleged conduct. Further, the number of cases the ACCC can take each year is limited, and its enforcement policy ensures cases taken reflect priorities and the likelihood of widespread and significant detriment being addressed.

While a franchisee may take a civil damages case against its franchisor, it would require substantial resources and a compelling case which, for most franchisees, is not likely to occur.

In short, it is unrealistic to expect the ACCC or a franchisee to take actions for alleged breaches of the CCA relating to the Franchising Code in any but the most significant circumstances, and such circumstances may not arise often. If there were to be offence provisions included in the Code, that in itself need not change the ACCC's enforcement resources or its enforcement policy, although business expectations may change.

The current regime is therefore not a panacea for all disputes arising in the franchise sector. The Code is a mandatory Code with which parties are expected and required to comply, but the likelihood of action being taken for a breach of the Code by the ACCC is low, while clauses enabling attribution of legal costs inhibit use of mandatory ADR.

This suggests that alternative or extended mechanisms are needed to deal with the vast majority of disputes and alleged breaches under the Code.

- Strengthening the alternative dispute resolution provisions of the Code would assist. Preventing attribution of legal costs by the franchisor (see above) is one element of this change. A second element could be the introduction of a stronger certification process under the Code along the lines of the RL Act. Under that Act, the VSBC can issue a certificate if mediation fails or is unlikely to resolve the dispute, or if a party refuses to mediate. This certificate enables the applicant party to progress the dispute to the Victorian Civil and Administrative Tribunal for determination. The Tribunal (generally a no-cost jurisdiction) may also order costs against the respondent party who refused to mediate. A variation to this proposal could be to require the parties to mediate in good faith, with a certificate issued if a party did not participate in good faith in mediation, and similar possibility of a costs order against that party in the relevant jurisdiction. The FDM Act requires good faith in the conduct of the parties at mediation (section 19) although such a provision brings with it the requirement for a judgement to be made as to whether good faith was observed, often by a body (e.g. VSBC) not present at the mediation.

- Infringement notices for certain breaches would provide a means by which some sanction would apply for the more 'black and white' breaches. While these notices would still need to be issued by the ACCC, and require sufficient evidence to support the breach, they are less resource intensive than litigation.

- Providing more equitable access to civil litigation if mediation is unsuccessful. The likelihood of a franchisee (in particular) taking civil action following a mediation which was unsuccessful or where the franchisor did not mediate in good faith, will be affected by the likely cost of taking further action. It is desirable that such matters be pursued in a low cost jurisdiction or via a low cost mechanism. The certification process noted above could assist, as would attribution of legal fees being void.

Conclusion

The VSBC has conducted many franchise-related mediations under the *Small Business Commissioner Act 2003 (Vic)* over the past ten years, with settlement rates around 80%, and expects to continue to do so. While most parties engage in mediation and participate in good faith, there are always those who do not. More concerning are unreasonable contractual barriers to franchisees (in particular) utilising low cost mediation services. The franchising relationship is a unique commercial arrangement, and the franchisor's negotiating position is often overwhelming.

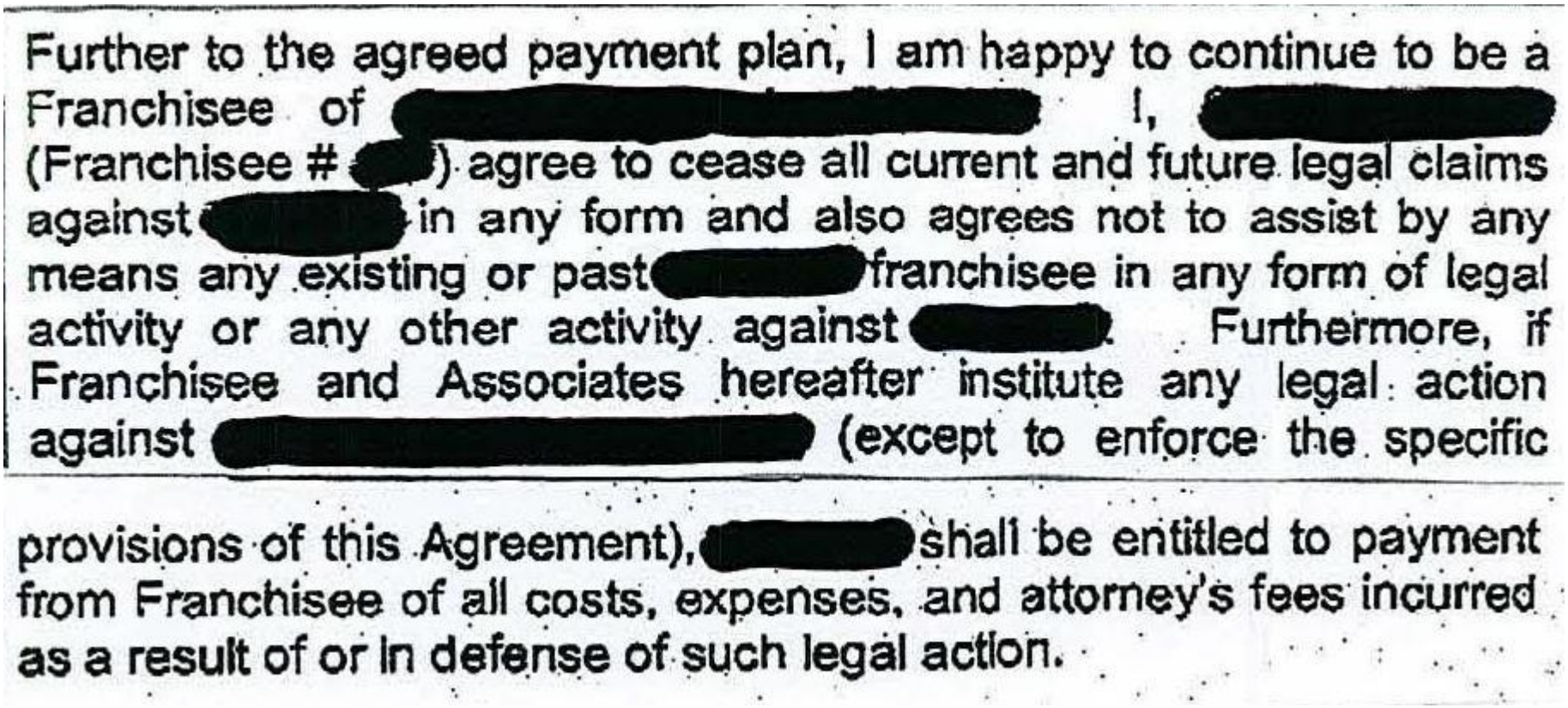
The *Retail Leases Act* 2003 (Vic) and the *Farm Debt Mediation Act* 2011 (Vic) provide certain measures which encourage participation in mediation in good faith. The prohibition of attribution of legal costs would assist in the emergence of a stronger dispute resolution regime for franchise disputes, supported by a possible certification scheme and the introduction of infringement notices for certain Code breaches, and better, simpler and more understandable disclosure requirements. A stratification for the valid and invalid use of certain unilateral variation clauses may also assist in improved commercial assessment of franchise opportunities by franchisees.

ATTACHMENT 1

VSBC - Matters involving franchising businesses
2003-2012

	TOTAL	Franchising Issues	Retail tenancy issues	Owner drivers issues	TOTAL	Franchising Issues	Retail tenancy issues	Owner drivers issues
TOTAL	257	154	102	1	100%	60%	40%	0%
2011-12	23	15	8		100%	65%	35%	0%
2010-11	26	18	8		100%	69%	31%	0%
2009-10	27	22	4	1	100%	81%	15%	4%
2008-09	72	45	27		100%	63%	38%	0%
2007-08	34	23	11		100%	68%	32%	0%
2006-07	22	10	12		100%	45%	55%	0%
2005-06	29	12	17		100%	41%	59%	0%
2004-05	17	9	8		100%	53%	47%	0%
2003-04	7	0	7		100%	0%	100%	0%

ATTACHMENT 2
PROPOSED CONFIDENTIALITY AGREEMENT TERMS



Further to the agreed payment plan, I am happy to continue to be a Franchisee of [redacted] I, [redacted] (Franchisee # [redacted]) agree to cease all current and future legal claims against [redacted] in any form and also agrees not to assist by any means any existing or past [redacted] franchisee in any form of legal activity or any other activity against [redacted]. Furthermore, if Franchisee and Associates hereafter institute any legal action against [redacted] (except to enforce the specific provisions of this Agreement), [redacted] shall be entitled to payment from Franchisee of all costs, expenses, and attorney's fees incurred as a result of or in defense of such legal action.