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The Treasury

Department of Innovation,  
Industry, Science and Research



# Strengthening statutory unconscionable conduct and the Franchising Code of Conduct

February 2010



# **Strengthening statutory unconscionable conduct and the Franchising Code of Conduct**

Report to the Hon Dr Craig Emerson MP  
Minister for Small Business, Independent Contractors  
and the Service Economy  
Minister for Competition Policy and Consumer Affairs

February 2010

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## LETTER TO THE MINISTER

The Hon Dr Craig Emerson MP  
Minister for Small Business, Independent Contractors  
and the Service Economy  
Minister for Competition Policy and Consumer Affairs  
Parliament House  
CANBERRA ACT 2600

Dear Minister

In response to the terms of reference provided to us on 26 November 2009, we are pleased to enclose our final report, *Strengthening statutory unconscionable conduct and the Franchising Code of Conduct*.

Yours sincerely

**Professor Bryan Horrigan**  
**Mr David Lieberman**  
**Mr Ray Steinwall**

**February 2010**



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## GLOSSARY

<b>ACCC</b>	Australian Competition and Consumer Commission
<b>ACL</b>	Australian Consumer Law
<b>ASIC</b>	Australian Securities and Investments Commission
<b>ASIC Act</b>	<i>Australian Securities and Investments Commission Act 2001</i>
<b>COAG</b>	Council of Australian Governments
<b>Franchising Code</b>	Franchising Code of Conduct (schedule to the <i>Trade Practices (Industry Codes--Franchising) Regulations 1998</i> )
<b>Issues paper</b>	<i>The nature and application of unconscionable conduct regulation: Can statutory unconscionable conduct be further clarified in practice</i> , released by Treasury on 27 November 2009
<b>Joint Committee</b>	Parliamentary Joint Committee on Corporations and Financial Services
<b>PC</b>	Productivity Commission
<b>TPA</b>	<i>Trade Practices Act 1974</i>



# FINDINGS

## UNCONSCIONABLE CONDUCT

### Findings

- 2.1 In many circumstances, statutory unconscionable conduct can be difficult for stakeholders to understand and for the courts to apply, which contributes to a lack of certainty and confidence surrounding the effect of the provisions.
- 2.2 A list of examples will not improve understanding or implementation of the provisions.
- 2.3 Interpretative principles, as an aid to interpretation of the provisions, would assist the courts in interpreting the provisions, stakeholders in understanding them and regulators in enforcing them.
- 2.4 The principles should recognise that section 51AC (and, arguably, section 51AB) of the TPA and equivalent provisions of the ASIC Act are intended to go beyond the scope of the equitable and common law doctrines of unconscionability, and are not confined by them.
- 2.5 The following principles may also be distilled from relevant case law and the policy intention of previous and current governments:
  - the court may consider the terms and progress of a contract;
  - the provisions may apply to systems of conduct or patterns of behaviour; and
  - the identification of a special disadvantage is not necessary to attract the application of the provisions.
- 2.6 Given there will be a single national law with respect to statutory unconscionable conduct under the Australian Consumer Law, with penalties and increased enforcement powers for regulators, it is timely for the ACCC, ASIC and state and territory regulators to develop uniform national guidance on the provisions, along similar lines to the guidance being prepared for the new unfair terms regime.
- 2.7 Regulators should pursue further test cases to inform their guidance material, over time. These test cases should draw on conduct in diverse industries, and should be used to assist in the understanding of the interpretative principles recommended by the panel.

### **Unconscionable conduct — Findings (continued)**

- 2.8 As part of the process for introducing statutory unconscionable conduct into the Australian Consumer Law, the Government should consider harmonising or unifying sections 51AB and 51AC.
- 2.9 The efficacy of the changes to statutory unconscionable conduct currently being introduced, and of any changes introduced as a result of this report, should be assessed after three to five years. This assessment will be assisted by improved mechanisms for empirical and other research, as discussed in Chapter 4.

## FRANCHISING CODE OF CONDUCT

### Findings

3.1 Legitimate commercial reasons exist for the **unilateral variation** of franchise agreements, particularly (but not solely) through amendments to the operations manual. For this reason, it is not appropriate to prohibit unilateral contract variation in the franchising sector.

3.1.1 The panel broadly supports franchisor disclosure of:

- the circumstances in which unilateral variations to their agreement may take place; and
- the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years.

3.2 **Capital expenditure** may be required of franchisees in order to maintain the competitiveness and responsiveness of the franchise business, and such outlays are not always foreseeable. To prohibit unforeseen capital expenditure would unduly constrain franchisors from making valid commercial decisions, and may not be a proportional response to a potentially confined problem.

3.2.1 In making a decision to enter the franchise, prospective franchisees need to be armed with whatever information is necessary to be able to undertake their due diligence and to fully appreciate whether it will be possible for them to recoup their investments, including investment in the form of unforeseen capital expenditure.

The insertion of a further disclosure item would also require franchisors to disclose whether or not a significant capital expenditure imposed on a franchisee towards the end of the franchise term would be a factor to be considered in end-of-term arrangements and whether that has been a factor in the past.

3.2.2 The panel therefore broadly supports disclosure under the Franchising Code of the possibility of unforeseen capital expenditure by the franchisee, particularly as a result of a franchisor amending the operations manual. This could also require disclosure of whether significant capital expenditure would be a factor to be considered in deciding to renew the franchise agreement.

## Franchising Code of Conduct — Findings (continued)

- 3.3 Where the **franchisee is seeking to sell its business**, there may be legitimate commercial and regulatory reasons for the franchisor to amend the franchise agreement; these amendments may take effect in some agreements toward the end of the term while in others toward the beginning. It is therefore not appropriate to prohibit this behaviour.
- 3.3.1 The provisions of the Franchising Code relating to transfer of a franchise agreement could be extended to cover novation of a franchise agreement.
- 3.3.2 The panel broadly supports up front disclosure of the possibility that a franchise agreement may be amended, even when the franchisee is seeking to sell the franchise.
- 3.4 Clauses **attributing legal costs** may be used for a variety of legitimate business purposes, including allowing the franchisor to facilitate dispute resolution with its franchisees, or allowing the franchisee to bear the risk of disputes arising in return for a lower franchise fee. Similar clauses exist in other industries.
- 3.4.1 However, such clauses may be used for inappropriate purposes. Clauses attributing legal costs irrespective of the outcome are particularly troubling. Where a weaker party is coerced into accepting such terms, the unconscionable conduct provisions of the TPA may apply.
- 3.4.2 The issue of cost-attribution during dispute resolution should be considered as part of an over-all approach to enhancing and harmonising dispute resolution facilities available to small business.
- 3.4.3 There is scope to clarify, in the Franchising Code, the meaning the Government intends to attach to ‘costs of mediation’, and the circumstances in which parties may agree otherwise than to bear their own costs.
- 3.4.4 The panel broadly supports improved disclosure up front of the cost-attribution of dispute resolution, to enable franchisees to better weigh the risks and rewards of entering a particular franchise system.
- 3.5 **Confidentiality agreements** may be used to advance a number of legitimate commercial interests, including the protection of intellectual property and trade secrets.
- 3.5.1 The panel broadly supports disclosure alerting prospective franchisees to the categories of information that cannot be discussed with existing and former franchisees. This could include, but would not be limited to outcomes of mediation, settlements, intellectual property, trade secrets or particular aspects of individual agreements.

## Franchising Code of Conduct — Findings (continued)

- 3.6 A short, simple, 'Plain English' document should be developed, to be provided to prospective franchisees before they are psychologically, financially and legally committed to entering a franchise agreement. This short document would be a ready reference to the nature of the franchise relationship.
- 3.7 The Government and the ACCC should consider ways to examine the nature and incidence of problems associated with these five behaviours, including through empirical research. This research, and advocacy more broadly, should inform guidance material for the franchising sector. The ACCC should consider whether additional educational activities are required in this area.
- 3.8 In relation to the franchising behaviours raised in this chapter, the provisions of the TPA may provide remedies where appropriate, for example, where the behaviour constitutes unconscionable conduct.

## OTHER MATTERS

### Findings

- 4.1 The issues connected with 'good faith' relevantly apply to the panel's work by virtue of their relationship with statutory unconscionable conduct and the five franchising behaviours (as discussed in Chapters 2 and 3).
- 4.2 The existence of the legal frameworks of the TPA and Franchising Code are important regulatory measures for fostering good business conduct. However, not all business disputes will fall within these frameworks, and it is not necessarily the function of the ACCC to arbitrate every commercial dispute, even where contraventions of the TPA are alleged.
- 4.3 Australian governments, and particularly the States and Territories, should consider whether there are any means whereby early intervention dispute resolution services for small business might be improved and harmonised across jurisdictions as part of existing or proposed reviews.
  - The issue of attribution of legal costs should form part of any examination of the effectiveness of dispute resolution mechanisms.

## Other matters — Findings (continued)

- 4.4 There should be more research (particularly empirical research) carried out concerning the interests of small business, particularly with respect to the effectiveness of the legal frameworks of the TPA and Franchising Code in protecting these interests. Such research is necessary in order to inform an evidence-based platform for review.
- Consequently, there is scope to improve advocacy and research, including empirical research, with respect to small business interests, including through the use of the *pro bono* resources of the legal profession and the expansion of existing processes considering consumer research and advocacy.
  - The impact of the changes the Government has already announced concerning unconscionable conduct and the Franchising Code, and any changes arising out of this report, should be a particular focus of this research framework. A period of three to five years would provide sufficient time to evaluate evidence of the effectiveness of these changes.
  - The issue of disclosure, particularly in the light of the panel's findings on disclosure in Chapter 3, should also form part of this research framework.



# 1 REGULATING BUSINESS CONDUCT

*In the paradoxical argot of Einstein's cosmologies the universe of professional discourse about Australia's Trade Practices Act 1974 may be thought of as unbounded but finite. That is to say it keeps on going but curves in upon itself.*

Justice Robert French, 2001<sup>1</sup>

The Hon Dr Craig Emerson MP, the Minister for Small Business, Independent Contractors and the Service Economy and Minister for Competition Policy and Consumer Affairs, has asked the panel to examine proposals concerning unconscionable conduct and the regulation of the franchising sector and report to him with its findings.

Specifically, the Minister asked the panel<sup>2</sup> to:

- consider whether a list of examples that all parties agree constitute unconscionable conduct, or a statement of principles concerning unconscionable conduct, should be incorporated into the *Trade Practices Act 1974* (TPA); and
- inquire into and report on the need to introduce into the Franchising Code of Conduct (Franchising Code) a list of examples of specific behaviours that may be inappropriate in a franchising arrangement, with particular reference to five behaviours:
  - unilateral contract variation;
  - unforeseen capital expenditure;
  - franchisor-initiated changes to franchise agreements when a franchisee is trying to sell the business;
  - attribution of legal costs; and
  - confidentiality agreements.

Unconscionable conduct and franchising have a considerable history in the policy debate on 'fair trading' and, with that in mind, this chapter explains this context with respect to the panel's work.

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1 French, R, 'The role of the courts in the development of Australian trade practices law' in Hanks, F and Williams, P (eds), *Trade Practices Act: A Twenty-Five Year Stocktake* (2001), 98-116, page 98. Justice French is now Chief Justice of the High Court of Australia.

2 The panel's full terms of reference are attached to the Government's response to the Senate Economics Committee report on '*the need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974*', which is available at [www.treasury.gov.au](http://www.treasury.gov.au).

## Current process

The panel was established on 27 November 2009, and at the same time an issues paper was released discussing the policy proposals recommended by the Senate Economics Committee. The panel has not been constrained to reviewing the submissions received in response to the issues paper in making its deliberations, and has had recourse to much of the material generated by previous work on franchising and unconscionable conduct. A description of the panel's consultation process can be found at Appendix A.

This report is the result of the panel's deliberations. In preparing the report, the panel has been assisted by secretariat services provided jointly by the Treasury and the Department of Innovation, Industry, Science and Research, recognising the responsibility of those portfolios for unconscionable conduct and franchising respectively. The panel appreciates the support provided by the departments.

The remainder of this chapter discusses the current state of the law on unconscionable conduct and franchising regulation, which frames the panel's analysis of the proposals before it. Chapter 2 discusses the proposals that have been put to the panel about unconscionable conduct, and Chapter 3 discusses the five franchising behaviours that were raised in the Government response to the Joint Committee report. These two chapters make recommendations for improving the effectiveness of the unconscionable conduct provisions of the TPA and the Franchising Code. Chapter 4 then addresses a range of other matters related to the panel's terms of reference, which have been raised as part of the inquiry process, specifically concerning good faith, dispute resolution, and research and advocacy.

## LAWS GOVERNING BUSINESS CONDUCT IN AUSTRALIA

In Australia, business conduct – both towards consumers and between businesses – is regulated in a number of ways. It includes generic rules, which apply to all traders in their interactions with consumers and one another, such as trade measurement laws, which prohibit the fraudulent misrepresentation of weights and measures in trade or commerce.<sup>3</sup> There are also industry-specific rules, such as the Uniform Consumer Credit Code (soon to be replaced by a national consumer credit regime<sup>4</sup>), statutory protections for consumers of energy services, and the Franchising Code.

These regulatory approaches target specific instances of harm, or specific industries where opportunities exist for businesses to engage in conduct considered inappropriate and contrary to the public interest. Since the 1970s, Australia's governments have enacted generic laws about 'unfair practices' have also been enacted, which may have general application to all businesses, all sectors and in all cases, or in more limited circumstances. The TPA is the principal national law of this kind.

Part V of the TPA prohibits various 'unfair practices'. It proceeds from a general prohibition of misleading or deceptive conduct in trade or commerce. This is then augmented by specific

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3 See Todd, J, *For Good Measure: the making of Australia's measurement system* (2004).

4 For further details on this reform, see [www.treasury.gov.au/consumercredit/](http://www.treasury.gov.au/consumercredit/).

prohibitions such as false or misleading representations, component pricing, bait advertising, harassment and coercion, and so on. Part V also regulates product safety and statutory conditions and warranties.

### Business conduct under the common law

Business conduct is also regulated through the common law. The doctrines of unconscionable conduct, for example, were developed by the courts of equity to address the most egregiously unfair conduct. The cornerstone for much of the development of these doctrines in Australia is the High Court's 1983 decision in *Amadio*.<sup>5</sup> In that decision, then Justice Mason described unconscionable conduct as:

an underlying general principle which may be invoked whenever one party by reason of some condition [or] circumstance is placed at a special disadvantage vis-à-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created.<sup>6</sup>

A brief outline of the development of the doctrines of unconscionable conduct by the courts in the last several decades is included in Appendix B.

In 1986, three years after the *Amadio* decision, Parliament introduced the concept of unconscionable conduct into the TPA. Section 52A (now section 51AB) prohibited conduct that is, in all the circumstances, unconscionable, in connection with the supply or possible supply of goods or services to consumers. The then Government felt that this prohibition would cover, at least, 'conduct of the kind discussed in *Commercial Bank of Australia Ltd v Amadio and Another*'.<sup>7</sup>

In 1992 the Government introduced section 51AA, which prohibits unconscionable conduct within the meaning of the unwritten law, from time to time, of the States and Territories. This made the TPA's remedies and the Trade Practices Commission's enforcement powers available in connection with the equitable and common law doctrines of unconscionable conduct. At the time there was speculation that this provision may extend significantly into commercial relationships.<sup>8</sup> However, the courts have largely restricted its application to the scope of the equitable and common law principles associated with unconscionable conduct.<sup>9</sup>

### 'Finding a balance: Towards fair trading in Australia'

On 26 June 1996, the Minister for Small Business and Consumer Affairs, the Hon Geoff Prosser MP, asked the House of Representatives Standing Committee on Industry, Science and Technology to investigate issues surrounding business conduct. The review was to

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5 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447. This case developed the doctrine enunciated in the High Court's earlier decision of *Blomley v Ryan* (1956) 99 CLR 362.

6 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 462, per Mason J.

7 Explanatory Memorandum, Trade Practices Revision Bill 1986, page 22.

8 See, for example, Healey, D, 'Unconscionable conduct in commercial dealings' (1993) 1 *Trade Practices Law Journal* 169-183.

9 See Tucker, P, 'Unconscionability: The hegemony of the narrow doctrine under the Trade Practices Act' (2003) 11 *Trade Practices Law Journal* 78-91.

examine issues particularly surrounding franchising and retail tenancy, and consider whether there was any conduct leading to sub-optimal economic outcomes.

The Committee, chaired by the Hon Bruce Reid MP, tabled its final report – *Finding a balance: towards fair trading in Australia* – on 26 May 1997, and made a number of recommendations directed at expanding the protections available to small businesses in Australia. In response, the previous Government in 1998 introduced a provision in the TPA governing unconscionable conduct in business-to-business transactions, and a mandatory, enforceable code of conduct for the franchising industry.

## UNCONSCIONABLE CONDUCT

The law of unconscionable conduct has its roots in the doctrines of the courts of equity, developed over the course of several centuries, to do what justice required in cases where the strict application of the law would be unduly harsh.<sup>10</sup> In Australia, the two key cases of *Blomley v Ryan* in 1956 and *Amadio* in 1983 set the tone of the judge-made law on unconscionable conduct, with may be characterised as addressing a situation where one party to a transaction is at a special disadvantage in dealing with the other, and the other party then ‘unconscientiously takes advantage of the opportunity thus placed in his hands’.<sup>11</sup>

The first of the three major unconscionability provisions in the TPA was introduced almost twenty years ago, and the newest twelve years ago. While the High Court has ruled in that time on the ways in which traditional doctrines of unconscionability or unconscientiousness provide legal relief<sup>12</sup>, it is yet to hear test cases that would provide the opportunity for it to settle the full meaning and application of the statutory concept.

For example, the High Court did not rule on the full scope of section 51AA in the only ACCC test case on statutory unconscionability to have thus far proceeded to judgment in that court. The leasing dispute in that case occurred before the introduction of section 51AC into the law.<sup>13</sup> There remains no judicially or academically settled view on all aspects of Part IVA, including the precise content and range of its individual provisions, the relationship between them, and their application across a range of industry sectors and circumstances.<sup>14</sup> At the

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10 Many of the early cases concerning what could be described as unconscionable conduct focused on ‘catching bargains’, or deals struck between moneylenders and expectant heirs at usurious rates of interest. For an account of the development of the law of unconscionable conduct generally see Carter, JW, Peden, E and Tolhurst, GJ, *Contract Law in Australia* (5th ed, 2007), pages 517-9.

11 *Blomley v Ryan* (1956) 99 CLR 362 at 415, per Kitto J. Further detail from this decision is extracted in Appendix B.

12 See, for example, *Bofinger v Kingsway Group Limited* [2009] HCA 44; *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315; and *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51.

13 *ACCC v CG Berbatis Holdings*.

14 See, for example, the case discussion and analysis in Buckley, R, ‘Sections 51AA and 51AC of the Trade Practices Act: the need for reform’ (2000) 8 *Trade Practices Law Journal* 5-16; Horrigan, B, ‘The expansion of fairness-based business regulation – unconscionability, good faith and the law’s informed conscience’ (2004) 32 *Australian Business Law Review* 159-92; Finn, P, ‘Unconscionable conduct?’ UNISA Trade Practices Workshop, 2006; Steinwall, R, *Annotated Trade Practices Act 1974* (2009 edition), pages 337-57; and Strickland, P, ‘Rethinking unconscionable conduct under the Trade Practices Act’ (2009) 37 *Australian Business Law Review* 19-49.

same time, some clear trends are emerging, which point the way for the law's further development.

## Statutory unconscionable conduct provisions

### Part IVA of the TPA

The TPA has three provisions prohibiting unconscionable conduct.

Section 51AA prohibits unconscionable conduct as it is understood within the meaning of the unwritten law, from time to time, of the States and Territories. This makes the remedies and enforcement provisions of the TPA available with respect to conduct the general law describes as unconscionable, and is not limited to transactions for the supply of consumer goods (as is the following provision). The provision is mirrored in section 12CA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), with respect to financial services, and in the Victorian fair trading law.<sup>15</sup>

Section 51AB prohibits unconscionable conduct directed towards consumers. As mentioned above, it was intended that this provision cover at least the situation described in the *Amadio* case. The provision is mirrored in section 12CB of the ASIC Act, and in the fair trading legislation of each State and Territory.<sup>16</sup>

Section 51AC prohibits unconscionable conduct in business transactions. It is mirrored in section 12CC of the ASIC Act, and in the fair trading legislation of Tasmania, Victoria and Western Australia.<sup>17</sup>

### Factors

Sections 51AB and 51AC provide a list of factors to which the court may have regard in making a determination of unconscionable conduct, without limitation. Both provisions include factors such as the relative strengths of the bargaining positions of the parties, whether a party is required to comply with conditions not reasonably necessary for the protection of the legitimate interests of the other, and whether any undue influence or pressure was exerted on, or any unfair tactics were used against a party.

Section 51AC has a longer list, including such factors as the requirements of applicable industry codes, consistency of conduct in different transactions, whether a contractual right to unilateral variation exists, and the extent to which the parties acted in good faith.

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15 *Fair Trading Act 1999* (Vic), section 7.

16 *Fair Trading Act 1992* (ACT), section 13; *Fair Trading Act 1987* (NSW), section 43; *Consumer Affairs and Fair Trading Act* (NT), section 43; *Fair Trading Act 1989* (Qld), section 39; *Fair Trading Act 1987* (SA), section 57; *Fair Trading Act 1990* (Tas), section 15; *Fair Trading Act 1999* (Vic), section 8; and *Fair Trading Act 1987* (WA), section 11.

17 *Fair Trading Act 1990* (Tas), section 15A; *Fair Trading Act 1999* (Vic), section 8A; and *Fair Trading Act 1987* (WA), section 11A.

## Other legislation

Unconscionable conduct is also prohibited under a number of industry-specific legislative schemes. For example, legislation governing retail tenancy – an industry the panel has been asked to consider in its review – in each jurisdiction prohibits unconscionable or similarly unfair conduct by parties to a retail lease.<sup>18</sup> Similar provisions can be found in legislation governing tourism services<sup>19</sup>, fitness services<sup>20</sup>, and residential property.<sup>21</sup>

Many of these provisions echo the terms of section 51AC of the TPA, and the statutory factors that are provided as being relevant to a finding of unconscionable conduct.

## Application and interpretation

There has been considerable judicial and academic debate surrounding the interpretation of the provisions in Part IVA. It is generally recognised that section 51AC (and possibly also section 51AB) goes some way beyond the scope of the doctrines of unconscionable conduct in the general law. However, how far it goes and what that means in practice are both matters of some contention. The meaning of ‘unconscionable conduct’ and the possibility of its definition were canvassed by the Senate Standing Committee on Economics (Senate Economics Committee) in its December 2008 report on ‘*the need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974*’.

In considering these issues, the panel has taken account of some of the key themes in this area, on the basis that an understanding of the recent development of the law is an essential precursor to a discussion of possible opportunities for further clarification or reform. In this regard, the panel considers it important to note the 2005 decision of the Full Federal Court in *Australian Securities and Investments Commission v National Exchange Pty Ltd*.<sup>22</sup>

### **ASIC v National Exchange**

In *ASIC v National Exchange*, the Full Federal Court considered that section 12CC of the ASIC Act (and, by extension, section 51AC of the TPA and other similarly framed legislation) is not to be constrained by the understanding of ‘unconscionable conduct’ in the general law:

There is no foundation in the language or purpose of s 12CC to impose limitations from the unwritten law ... Authority on s 51AC supports the proposition that the prohibition in s 12CC is not to be read down by limiting its operation only to circumstances where the common law would grant relief in respect of unconscionable conduct ... It is equally clear both from the actual language of s 51AC and of s 12CC

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18 *Leases (Commercial and Retail) Act 2001* (ACT), section 22; *Retail Leases Act 1994* (NSW), section 62B; *Business Tenancies (Fair Dealing) Act* (NT), sections 79, 80, 81; *Retail Shop Leases Act 1994* (Qld), sections 46A, 46B; *Retail and Commercial Leases Act 1995* (SA), sections 20K, 20L, 20M; *Code of Practice for Retail Tenancies* (Tas), clause 3; *Retail Leases Act 2003* (Vic), sections 77, 78, 79; and *Commercial Tenancy (Retail Shops) Agreements Act 1985* (WA), sections 15C, 15D, 15E.

19 *Tourism Services Act 2003* (Qld), section 35.

20 *Fitness Industry Code of Practice* (Qld), clause 7.

21 *Property Agents and Motor Dealers Act 2000* (Qld), section 573B.

22 (2005) 148 FCR 132.



and from the extrinsic materials relating to s 51AC that these provisions were intended to build on and not to be constrained by common law case law ... The language must be given its ordinary meaning and must not be qualified by pre-existing constraints on liability.<sup>23</sup>

The Full Federal Court articulated a number of propositions about statutory unconscionability, which provide an important platform for the panel's recommendations, as well as regulatory guidance and test cases from here. Briefly, these propositions may be summarised as follows:

- section 51AC of the TPA and section 12CC of the ASIC Act mirror one another, so they should be interpreted in similar ways;<sup>24</sup>
- as these provisions do not refer back to unconscionable conduct under 'the unwritten law' and refer to conduct that is unconscionable 'in all the circumstances', they are not limited to what unconscionable conduct means or remedies under the unwritten law, and are meant to 'build on' and not be constrained by that body of law<sup>25</sup>;
- section 51AC was introduced into the TPA 'to protect persons engaged in small business', especially in the light of policy considerations mentioned in the accompanying second reading speech such as the need 'to better protect the legal rights of small businesses, to ensure that small businesses can confidently deal with large firms [and to] provide a new substantive legal remedy for small business against unconscionable conduct';<sup>26</sup> and
- The correct approach to interpreting and applying these provisions is as follows<sup>27</sup>:

'Unconscionable conduct', on its ordinary and natural interpretation, means doing what should not be done in good conscience ... and, as Spigelman J stated in *Attorney General of NSW v World Best Holdings Ltd*, '[u]nconscionability is a concept which requires a high level of moral obloquy' ... [T]he question is whether the conduct ... was 'unconscionable', according to the ordinary and natural meaning of that term, having regard to the list of statutory considerations.

The starting point in making this determination as to unconscionability is the list of factors to which the Court's attention is drawn by s 12CC(2). These factors should be considered and weighed as a whole. Some may weigh in favour of a characterisation of the conduct as unconscionable and others may not. It is not appropriate to approach this list as exhaustive. This list is indicative of some of 'the relevant circumstances'.

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23 *ibid.*, at 140, per Tamberlin, Finn and Conti JJ.

24 *ibid.*, at 143-4. This point means that any legislative reform, regulatory guidance or judicial decision on either section has implications for the other. The panel's recommendations are sensitive to this ripple effect, which applies equally to state and territory unconscionable conduct laws.

25 *ibid.*, at 140.

26 *ibid.*, at 140, 143.

27 *ibid.*, at 140, 142.

In the absence of a definitive High Court decision, the Full Federal Court decision may be taken as authoritative at this time.<sup>28</sup> Certainly, in combination with the decision in *Attorney General of NSW v World Best Holdings Ltd*,<sup>29</sup> the *National Exchange* decision points the way to the developing treatment of statutory unconscionable conduct in intermediate appellate courts. However, given the broad range of judicial opinion on this question, it may be that a more definitive statement is still to come.

### Beyond *Amadio*

It may be said with more confidence that ‘unconscionable conduct’ at common law extends beyond the *Amadio*-type scenario and captures other conduct for which equity has historically provided relief. In *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd*, the Full Federal Court noted that equity ‘is directed to the prevention of unconscionable behaviour’.<sup>30</sup> The Court found (in obiter) that five categories of case could be said to fall under the banner of ‘unconscionable conduct’ and therefore be within the scope of section 51AA:

- *Amadio*-type unconscionable conduct;
- transactions entered into because of a lack of comprehension by one party, the influence of another and a lack of independent advice (as in *Garcia v National Australia Bank Ltd*<sup>31</sup>);
- equitable estoppel, that is, preventing the exercise of a legal right in such a way that it would be an unconscionable departure from a representation relied upon by another to his detriment (as in *Walton Stores (Interstate) Limited v Maher*<sup>32</sup>);
- relief against forfeiture and penalty (as in *Legione v Hately*<sup>33</sup>); and
- rescission of contracts on the basis of unilateral mistake (as in *Taylor v Johnson*<sup>34</sup>).<sup>35</sup>

With respect to the *Amadio* category, *Samton* also sheds light on the ‘special disadvantage’ element of unconscionable conduct. The special disadvantage may be either of a ‘constitutional’ kind, for example ‘deriving from age, illness, poverty, inexperience or lack of education’, or it may be of a ‘situational’ kind, ‘deriving from particular features of a relationship between actors in the transaction such as the emotional dependence of one on

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28 especially in the light of the High Court’s precedential instruction to Australian courts in *Farah Constructions Pty Ltd v Say-Dee* (2007) 81 ALJR 1107 at 1140.

29 (2005) 63 NSWLR 557.

30 (2002) 189 ALR 76 at 91, per Gray, French and Stone JJ, drawing on Finn, P, ‘Unconscionable Conduct’ (1994) 8 *Journal of Contract Law* 37 at 38-9.

31 (1988) 194 CLR 395.

32 (1988) 164 CLR 387.

33 (1982) 152 CLR 406.

34 (1983) 151 CLR 422.

35 *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd* (2002) 189 ALR 76, at 92. For a more detailed discussion of the *Samton* decision see Pearson, G, ‘The ambit of unconscionable conduct in relation to financial services’ (2005) 23 *Company and Securities Law Journal* 105 at 112-3.



the other'.<sup>36</sup> The basis for this latter kind of special disadvantage is drawn from the High Court's 1992 decision in *Louth v Diprose*.<sup>37</sup>

### Recent successes

There are no signs that the development of case law surrounding statutory unconscionable conduct is slowing to any significant extent. The ACCC has indicated it has a 'renewed determination' to bring cases under the unconscionable conduct provisions.<sup>38</sup> The Senate Economics Committee noted the view of some stakeholders that the ACCC had been remiss in its obligations with respect to the unconscionable conduct provisions, with only two successful actions under section 51AC having been brought at the time of the Committee's report.<sup>39</sup>

It is important to note that an effective testing and exploration of new provisions can result in some losses, as the ambit of the law is settled. Further, the figure of 'only two' successful judgments represents only a fraction of the ACCC's unconscionable conduct actions and understates the ACCC's broad enforcement activities, which often results in successful resolution of matters before a final judgment. Moreover, the ACCC has been increasingly successful in its enforcement actions, and in 2009 achieved some noteworthy successes. Details of the ACCC's enforcement activities with respect to unconscionable conduct are set out in Appendix C, however, one recent matter in particular highlights an emerging understanding about the application of the law to systems of business conduct.

### *Craftmatic*

On 29 June 2009, the ACCC accepted a court enforceable undertaking from Craftmatic Pty Ltd, which the ACCC believed to have engaged in unconscionable conduct by using unfair pressure tactics to sell therapeutic beds to vulnerable elderly consumers.<sup>40</sup> The ACCC alleged that Craftmatic 'took advantage of people who in some cases were house bound, commercially inexperienced, may have had health concerns and were susceptible to high pressure sales techniques'.<sup>41</sup> Craftmatic consented to declarations and injunctions made against it during Federal Court proceedings.

A system or pattern of business conduct may itself be unconscionable, without reference to individual transactions. Naturally, as an evidentiary matter, the ACCC's investigation uncovered instances where the conduct of Craftmatic towards specific consumers could be considered unconscionable. But it was the business system that Craftmatic had put in place that was itself unconscionable and the subject of the enforcement action. The undertaking

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36 *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd* (2002) 189 ALR 76 at 91 (applied at 92), per Gray, French and Stone JJ. This approach was endorsed by Gleeson CJ in *Australian Competition and Consumer Commission v CG Berbatis Holdings Ltd* (2003) 214 CLR 51 at 63.

37 (1992) 175 CLR 621.

38 See the ACCC's evidence to the Senate Economics Committee, Parliament of Australia, Sydney, Monday 3 November 2008, page E9 (Mr Scott Gregson, General Manager, Coordination, Enforcement and Compliance Division).

39 Senate Economics Committee, Parliament of Australia, *The need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974* (2008), pages 11, 39.

40 A copy of the undertaking is available on the ACCC's website, [www.accc.gov.au](http://www.accc.gov.au).

41 ACCC, 'Door to door sellers must clean up act after ACCC action against Craftmatic' (media release, 19 June 2009).

signed by Craftmatic's directors acknowledges the ACCC's position 'that the sales method designed and implemented by Craftmatic led to a systematic exploitation of its customers, typically elderly persons, which in all of the circumstances amounted to unconscionable conduct in contravention of section 51AB of the [TPA]'.<sup>42</sup>

### **Forthcoming changes**

In 2009, the Government undertook to make some changes to the unconscionable conduct provisions. The panel's work therefore proceeds from the starting point that there will be changes to clarify and enhance the law on unconscionable conduct. This provides an opportunity for further improvement if it is needed.

The provisions of Part IVA of the TPA will form part of the Australian Consumer Law (ACL), which is to be established as a schedule to the TPA by the Trade Practices (Australian Consumer Law) Bill 2009 and fully enacted in a second Bill. Under the terms of the *Intergovernmental Agreement for the Australian Consumer Law*<sup>43</sup>, the States and Territories will apply the ACL as a law of their jurisdictions, and will repeal or amend any legislation that is inconsistent with the ACL or would alter its effect.

There will be a single national generic law on unconscionable conduct. There will also remain industry-specific regimes which address aspects of unconscionable conduct, particularly, for example, in the regulation of retail leases. To the extent these regimes reflect the influence of the generic statutory unconscionable conduct, they are likely to be influenced by the changes that have been announced to the generic regime, as well as any further changes that may be introduced.

### **Enforcement**

The ACL provisions on unconscionable conduct will be enforced with the assistance of a range of new enforcement powers. There will be civil penalties of up to \$1.1 million for corporations, and \$220,000 for individuals, for engaging in statutory unconscionable conduct. Regulators will be able to seek orders disqualifying individuals who engage in unconscionable conduct from managing corporations. Regulators will also be able to issue public warnings about parties they believe to have contravened the law, and will be able to seek a single order providing redress for harmed non-parties.

These new provisions will serve as a powerful disincentive to contravention of the unconscionable conduct provisions, and will strengthen the hand of regulators when negotiating with businesses alleged to have engaged in such conduct. To the extent that the larger penalties will prompt greater businesses awareness of their obligations under the unconscionable conduct provisions, this will also create a need for additional training in trade practices compliance. Regulators have a role in ensuring compliance training – whether voluntary or as a result of court orders or enforceable undertakings – is effectively

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42 *Trade Practices Act 1974 – Undertaking to the Australian Competition and Consumer Commission given under section 87B by Craftmatic Australia Pty Ltd*, accepted 29 June 2009, paragraph 4.

43 available at the COAG website, [www.coag.gov.au](http://www.coag.gov.au).

carried out, and will be in a position to perform this role through the provision of additional guidance about the use and effect of the civil penalty regime.

### Clarifying amendment

In the Government's response to the Senate Economics Committee's report on unconscionable conduct, it accepted the Committee's recommendation of an amendment to clarify the effect of section 51AC of the TPA. This amendment will form part of the ACL, and it is understood that it will make it clear that the terms and progress of a contract may be relevant to a finding of unconscionable conduct. The amendment will address the concerns of stakeholders about 'substantive unconscionability', and is not intended 'to alter the prohibition or create a new standard of business conduct'.<sup>44</sup> To the extent that this current process is to examine options to bring greater clarity to the provisions, it must be borne in mind that the Government has already announced this measure to clarify the provision.

### State of the law

Australian law in this area is relatively well developed compared to other jurisdictions. No other jurisdiction of which the panel is aware has a more comprehensive statutory prohibition of unconscionable conduct as can be found in Part IVA of the TPA. Such a provision has not developed, for example, in the UK<sup>45</sup>, where the doctrines of equitable unconscionable conduct were originally developed. Indeed, for a time there was a concern that in England and Wales even the equitable remedies for unconscionable conduct may be disappearing.<sup>46</sup>

Instead, the UK is implementing of the European Commission's *Unfair Commercial Practices Directive*. The Directive was introduced in UK law by the *Consumer Protection from Unfair Trading Regulations 2008*. The Regulations prohibit unfair commercial practices, including practices contrary to the requirements of 'professional diligence'. This concept is defined as including 'honest market practices' and 'the general principles of good faith', and UK courts have already experienced difficulty in applying these unfamiliar concepts.<sup>47</sup>

That Australia has a well developed law on unconscionable conduct is not, on its own, reason to suggest no further developments are necessary. However, it does highlight the thorough examination that these issues have received in Australia, and raises the difficulty of being unable to point to other jurisdictions as precedents for any logical next steps.

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44 Commonwealth Government response to the senate standing committee on economics report on the need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974, <[http://www.treasury.gov.au/documents/1659/PDF/Government\\_response.pdf](http://www.treasury.gov.au/documents/1659/PDF/Government_response.pdf)> at 13 January 2010, page 3.

45 The National Association of Retail Grocers of Australia (NARGA) submission suggests an examination of section 18 of the *Competition Act 1998* (UK), which prohibits the abuse of a dominant position. However, in many respects, this provision bears more in common with the prohibition of abuse of market power in section 46 of the TPA than with the doctrine of unconscionable conduct.

46 See Enman, SR, 'Doctrines of Unconscionability in Canadian, English and Commonwealth Contract Law' (1987) 16 *Anglo-American Law Review* 191 at 217, cited in Carter, JW, Peden, E and Tolhurst, GJ, *Contract Law in Australia* (4th ed, 2002), page 529.

47 See, for example, the decision of Mr Justice Eady in *Tiscali UK Limited v British Telecommunications PLC* (2008) EWHC 3129 (QB).

## FRANCHISING CODE OF CONDUCT

The Franchising Code has been in operation for as long as section 51AC. However, it does not have the same jurisprudential history as the unconscionable conduct provisions, reflecting its rather different function as a set of conduct rules for a specific sector.

Furthermore, there has been little or no extended conceptual debate about the meaning, effect or application of its terms. It is around the terms of the Franchising Code itself – or, rather, terms that do not appear in the Code – that debate has tended to take place.

The Franchising Code is a mandatory industry code of conduct prescribed under Part IVB of the TPA. If a corporation breaches its obligations under the Franchising Code, it contravenes section 51AD. A range of remedies are available under Part VI for contravention of section 51AD, including injunctions, damages and other orders. Where the Franchising Code is breached, the proper legal remedies are those provided by the TPA – the consequences applying at common law to illegality do not automatically apply.<sup>48</sup>

The purpose of the Franchising Code is to regulate the conduct of participants in franchising (including potential franchisees) towards each other. The objectives of the Code are to:

- address the imbalance of power between franchisors and franchisees;
- raise the standards of conduct in the franchising sector without endangering the vitality and growth of franchising;
- reduce the cost of resolving disputes in the sector; and
- reduce risk and generate growth in the sector by increasing the level of certainty for all participants.<sup>49</sup>

The Franchising Code is divided into three substantive parts: Part 2, concerning disclosure; Part 3, concerning the conditions of franchise agreements; and Part 4, which provides a mechanism for resolving disputes in franchising relationships.

Under the Franchising Code, franchisors must disclose specific facts to franchisees about the franchise business and to follow set procedures in dealing with franchisees. Franchisors must also provide prospective franchisees with a disclosure document outlining the terms of the arrangement and each party's obligations. The Franchising Code aims to assist franchisees to undertake their due diligence and make informed decisions prior to entering into a franchise agreement, as well as to facilitate dispute resolution through a cost-effective mediation scheme for franchisors and franchisees to resolve their disputes.

### Forthcoming changes

On 1 December 2008 the Parliamentary Joint Committee on Corporations and Financial Services (the Joint Committee) tabled its report on the Franchising Code and related matters.

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48 *Master Education Services Pty Limited v Ketchell* (2008) 236 CLR 101.

49 Explanatory Statement, *Trade Practices (Industry Codes – Franchising) Regulations 1998*.

The Government released its response to this report on 5 November 2009, in conjunction with the response to the Senate Economics Committee report on unconscionable conduct. It is important to note that the Government has announced a number of changes to the Code and its enforcement arrangements in the wake of the Joint Committee report.<sup>50</sup>

### Changes to the Code

In its response to the Joint Committee report, the Government has outlined a range of changes to the regulatory environment of the franchising sector. For instance, the Government committed to enhancing the dispute resolution system under the Franchising Code by including a list of 'mediation behaviours', designed to encourage parties to a dispute to approach mediation in a reconciliatory manner. The behaviours include attending and participating in meetings at reasonable times, observing confidentiality, making intentions clear at the outset of mediation, and avoiding damage to the franchise brand during the dispute.<sup>51</sup>

The Government will amend the Franchising Code to require franchisors to inform franchisees six months before the end of the agreement (or one month for agreements of less than six months) of whether or not the agreement will be renewed. Franchisors will also be required to disclose up front what arrangements will apply at the end of the term, including any right to renewal.<sup>52</sup> While these changes will apply prospectively to agreements signed after the amendments commence, parties to a franchising arrangement may voluntarily agree that these changes apply to their franchising agreement.

The Government will also:

- amend the disclosure provisions of the Franchising Code to include a statement alerting potential franchisees that a franchise, like any business, may fail;<sup>53</sup>
- change the name of the Office of the Mediation Adviser to the Office of the Franchising Mediation Adviser;<sup>54</sup> and
- support the public release of data on trends of inquiries and complaints from small businesses and franchising businesses, and work with the industry to gain further insights into the stability of the sector.<sup>55</sup>

### Changes to the enforcement regime

In addition to the changes to the Franchising Code, the Government announced changes to the enforcement arrangements for all industry codes prescribed under Part IVB of the TPA. The Government committed to introducing an 'enhanced enforcement package', augmenting

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50 The full text of the Government response is available on the website of the Department of Innovation, Industry, Science and Research, [www.innovation.gov.au](http://www.innovation.gov.au).

51 See pages 15-6 of the response.

52 *ibid.*, pages 14-5.

53 *ibid.*, pages 21-2.

54 *ibid.*, page 19.

55 *ibid.*, pages 19-20.

the existing civil remedies available for breaches of the Franchising Code and improving the ACCC's investigative and enforcement powers.<sup>56</sup>

This enhanced enforcement package will include:

- non-party redress, allowing the court to order redress (but not damages) for large numbers of businesses (including franchisees) affected by a breach of an industry code;
- substantiation notices, requiring businesses to substantiate the claims they make in promoting their goods or services (for example, the claims of a franchisor concerning the profitability of its franchise system);<sup>57</sup>
- public warning notices, allowing the ACCC to alert the public to conduct which may be in breach of an industry code; and
- a 'random audit power', allowing the ACCC to request and be given copies of documents or information required to be kept by an industry code.

These changes will be part of the second Bill to establish the ACL, which is expected to be introduced early in 2010.

## CONTEXT OF THIS REPORT

This report also takes account of a series of examinations of business conduct affecting small businesses, stretching back at least to the introduction of the TPA in 1974. A summary of previous reviews that have considered unconscionable conduct and franchising regulation is at Appendix D. This includes the 'Finding a balance' report of 1997 which led to the introduction of section 51AC of the TPA and the Franchising Code of Conduct.

### Recent reviews

The immediate context of this report is the two recent Parliamentary inquiries – one into franchising, the other into unconscionable conduct – in response to which the Government established this panel.

### Unconscionable conduct

On 16 September 2008 the Senate Economics Committee began its inquiry into the 'need to develop a clear statutory definition of unconscionable conduct for the purposes of Part IVA of the *Trade Practices Act 1974* and the scope and content of such a definition'. The Committee reported on 3 December 2008. It did not recommend a definition of unconscionable conduct, but instead made recommendations directed at improving the clarity of the scope of the provisions.

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<sup>56</sup> *ibid.*, pages 9-10.

<sup>57</sup> This is the same mechanism included in the Trade Practices Amendment (Australian Consumer Law) Bill 2009, Schedule 2, Part 3.



The Committee's report considered two possible amendments to the unconscionable conduct provisions: a list of examples that all parties agree constitute unconscionable conduct; and a statement of principles concerning unconscionable conduct. However, the Committee did not come to a final view on these proposals, and recommended they be considered further.

## Franchising

During 2007 and 2008, public concerns about fairness in franchising resulted in a number of reviews of the Franchising Code and, more widely, the franchising sector. On 2 November 2007 then WA Minister for Corrective Services and Small Business, the Hon Margaret Quirk MLA, announced an inquiry into franchising in WA (the WA inquiry), in response to concerns raised in the WA Parliament that existing arrangements do not adequately protect franchisees. The WA inquiry reported to the previous WA Government on in April 2008.

On 24 October 2007 the Economic and Finance Committee of the SA Parliament resolved to hold an inquiry into the efficacy of franchising regulation (the SA inquiry). The SA Committee reported in May 2008.

The WA inquiry found that while improvements could be made to the regulation of franchising, the sector was generally functioning well. However, the SA inquiry made extensive recommendations for amendment to the Franchising Code. It also recommended the introduction of a statutory definition of unconscionable conduct.

On 25 June 2008 the Australian Parliament's Joint Committee on Corporations and Financial Services resolved to inquire into the Franchising Code and related matters. The Joint Committee's report, tabled on 1 December 2008, made eleven recommendations directed at improving regulation in the franchising sector. These recommendations included proposals relating to dispute resolution, enforcement, disclosure, data collection and good faith.

Good faith is of relevance to the panel's work, because of the Joint Committee's recommendation and because of its presence as a factor courts may consider in making a finding of unconscionable conduct. It is discussed in terms of its relevance to the panel's work in Chapter 4.

While the Government accepted the intent of the Joint Committee's recommendation on good faith, the Government considered that the inclusion of a general obligation of good faith in the Franchising Code would increase uncertainty in franchising. As part of the consultation process in preparing its response to the Joint Committee's report, however, specific behavioural issues were brought to the Government's attention. Consequently, part of the Government's practical response to the good faith recommendation is to ask the panel to consider whether further amendments to the Franchising Code were required to address these specific behaviours.





## 2 UNCONSCIONABLE CONDUCT PROPOSALS

### Key points

- A statutory list of examples of unconscionable conduct would not assist the development of the unconscionable conduct provisions of the TPA, and would be difficult to construct given the range of industries to which it must apply.
- A statement of interpretative principles is better suited to clarifying Part IVA than would be a list of examples. The principles should be framed so as to assist an expanded interpretation of the provisions but not so as to hinder their development.
- The differences in the drafting and application of the provisions in sections 51AB and 51AC may not be meaningful, and consideration should be given to unifying the provisions.
- National, state and territory regulators should work collaboratively to provide more guidance and educative material concerning the law of unconscionable conduct, enhanced to reflect the augmented enforcement arrangements and, if introduced, the statement of interpretative principles.
- The ACCC and ASIC, responsible for enforcing the cognate provisions in the TPA and ASIC Act respectively, should continue to pursue test cases in diverse industries, in particular to aid in the interpretation of recent and proposed amendments.
- Unconscionable conduct should feature as part of the Government's announced initiatives on consumer and small business research, which is discussed in Chapter 4.
- Effective and timely dispute resolution is important for all businesses, especially small businesses. Chapter 4 discusses the importance of simplifying and strengthening dispute resolution mechanisms.
- In relation to the five franchising behaviours discussed in Chapter 3, the unconscionable conduct provisions of the TPA may provide remedies where appropriate.
- The efficacy of the announced changes to the unconscionable conduct provisions, and of any changes arising out of the panel's report, should be assessed after three to five years, informed by the research agenda referred to above.

## PROPOSALS FOR REFORM

On 27 November 2009, Treasury released an issues paper canvassing these two options, as well as a range of non-legislative options.<sup>58</sup> Further detail on the options is available in the issues paper; however, the options are outlined briefly below.

### A list of examples<sup>59</sup>

The Senate Economics Committee recommended consideration of a list of examples of unconscionable conduct that would act as statutory presumptions of unconscionability. If the conduct of a party fell inside the factual scenario described by an example, the burden would fall on that party to demonstrate its conduct was not unconscionable.

The issues paper also discussed two other forms of a list of examples. The examples could be in endnotes – not part of the provisions themselves but an aid to their interpretation. Alternatively, the examples could be incorporated in the TPA itself, as an influential but still non-determinative indication of unconscionability.

### A statement of principles<sup>60</sup>

The Committee's proposed 'statement of principles' of unconscionable conduct would be a list of factors to which the court must have regard in making a finding of unconscionable conduct. This is in contrast to the lists of factors currently in sections 51AB and 51AC of the TPA, which are simply factors to which Parliament invites courts to have regard in making their determinations.

The issues paper raised the possibility of a statement of principles more akin to the objects clause of an Act or part of an Act. Like section 44AA of the TPA, which outlines the objects of Part IIIA, this kind of statement of principles would be an interpretive aid for courts along the lines envisaged by section 15AA of the *Acts Interpretation Act 1901*.

### Non-legislative options<sup>61</sup>

The issues paper also raised three alternatives for improving the clarity and effectiveness of the law.

- Regulators could provide greater guidance about the meaning and application of the unconscionable conduct provisions, and the circumstances in which they would be prepared to take legal action. This guidance could be made uniform and national, given the consolidation of unconscionable conduct laws in the ACL.
- The scope for greater use of enforceable undertakings under section 87B of the TPA could be examined, to prevent unconscionable conduct in a greater number of instances.

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58 See Treasury, *The nature and application of unconscionable conduct regulation*, November 2009, [http://www.treasury.gov.au/documents/1676/PDF/Unconscionable\\_Conduct\\_Issues\\_Paper.pdf](http://www.treasury.gov.au/documents/1676/PDF/Unconscionable_Conduct_Issues_Paper.pdf) at 14 January 2010, (hereafter the 'issues paper').

59 See pages 9-13 of the issues paper.

60 See pages 13-5 of the issues paper.

61 See pages 15-7 of the issues paper.

- The increased use of industry codes, or more detail in industry codes concerning unconscionable conduct, could also be a means to improving clarity and enforcement of the law.

## THE PROBLEM

### Is there a problem?

Submissions received in response to the issues paper<sup>62</sup> do not provide an indication of broad stakeholder agreement about options for reform, whether any reform would be beneficial, or indeed whether there exists any problem at all to be remedied by any reform. There are, as with previous inquiries in this area, strongly divergent views. While not seeking to oversimplify, the panel identified two broad bodies of opinion in the submissions.

On the one hand, there were many submissions to the effect that the current provisions should be left alone. The reasons expressed for that view included satisfaction with the current state of the law, contentment with leaving further development of the law to the courts, and caution about more reform before the impact of the announced reforms becomes apparent. For example, Freehills' submission argues that further change should be resisted until announced changes are in force and can be absorbed by the business community.<sup>63</sup>

On the other hand, there were also many submissions indicating that the law was in need of an 'overhaul', or a change of approach was needed, predominately on the basis that the provisions were out of reach of the average small business. Some submissions therefore argue for a new or substantially altered regime governing inappropriate, unfair or abusive conduct, to take the place of statutory unconscionability.<sup>64</sup>

Some stakeholders argued that they saw no problem here to be solved, or, if there are problems, they are industry-specific and should not be allowed to intrude upon the proper functioning of the generic law.

Abacus, for example, indicated that it was:

concerned that the Paper does not explain why clarification of these somewhat technical issues of statutory interpretation is sufficiently important to possibly justify amending the legislation, or other regulatory intervention.

Specifically, the Paper does not address what the real world problems are that need to be addressed. Equally importantly, it gives no indication of how these perceived problems might be ameliorated by the adoption of any of the measures canvassed to clarify the legislative provisions.<sup>65</sup>

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62 Submissions that do not contain confidential material are available on the Treasury website, [www.treasury.gov.au](http://www.treasury.gov.au).

63 *passim*.

64 See, for example, National Independent Retailers Association submission, *passim*.

65 Abacus submission, page 1.

The Shopping Centre Council of Australia (SCCA) was unequivocal:

There is no evidence that the unconscionable conduct provisions in Part IVA of the *Trade Practices Act* are confusing to the courts, or to relevant tribunals; nor to the body given primary responsibility for enforcing these provisions, the Australian Competition and Consumer Commission. There is no justification, therefore, for major changes to these provisions of the Act – whether through the inclusion of a list of examples or the inclusion of a statement of principles – to give greater clarity and guidance to the courts concerning the meaning of these provisions.<sup>66</sup>

Professors Christensen and Duncan from the Queensland University of Technology considered that if the problem was a lack of comprehension by the layman, the proposed solutions are ill-proportioned and carry risks. While the unconscionable conduct provisions ‘are such that a lay reader might make little sense of them without greater legal context, we do not consider this is a reason justifying a resort to examples that in some cases could lead to consumers making incorrect assumptions about their rights’.<sup>67</sup>

Other stakeholders argued that the problem with the provisions is their under-utilisation, on the basis that the ‘bar’ is set too high and therefore the difficulties facing small businesses go unaddressed. The Post Office Agents Association Limited, for example, indicated ‘that unconscionable conduct is alive and well’.<sup>68</sup> By this it may be taken to mean not that the doctrines of unconscionable conduct are well used and operating effectively, but that conduct it considers to be unconscionable continues to be engaged in with impunity.

In the same vein, some stakeholders suggested the problem with unconscionable conduct is that it is not effective in remedying business disputes, and that conduct that is characterised as ‘unacceptable’ should be prohibited. On this basis, the Motor Trades Association of Australia recommended<sup>69</sup> including a list of unacceptable conduct in the TPA, and the Pharmacy Guild of Australia recommended a clear prohibition of unacceptable conduct.<sup>70</sup>

The Council of Small Business of Australia felt that the problem was, generally, ‘unfair dealings that may affect small businesses’. The problem with the unconscionable conduct provisions is that they ‘are too far from the reach of small business owners’, and there is no ‘recourse or protection for small business owners who are taken advantage of by franchisors nor by unscrupulous retail landlords’.<sup>71</sup>

Some submissions noted that there may be problems in particular industries. Notable among these industries are the franchising and retail tenancy industries, to which the attention of the panel has been specifically drawn by the terms of reference, and which have been the focus of the ‘fair trading’ debate for several decades. Several submissions complained of

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66 SCCA submission, page 1.

67 Professors Christensen and Duncan submission, page 2.

68 Post Office Agents Association Limited submission, page 1.

69 Motor Trades Association of Australia submission, page 1.

70 Pharmacy Guild of Australia submission, page 2 and passim.

71 Council of Small Business of Australia (COSBOA) submission, page 2.

unfair conduct by a franchisor<sup>72</sup>, or noted complaints about conduct in the real estate and energy industries.<sup>73</sup> However, many submissions which acknowledge industry-specific issues also raise the point that these are not problems with the unconscionable conduct provisions, but problems in the industries concerned, and would be best dealt with by industry-specific measures.<sup>74</sup>

### Identifying the problem

Both the Government's response to the Senate Economics Committee report, and the terms of reference it established for this panel, speak of the importance of clarity in the law and understanding of it. The panel is asked to assess the proposals for reform according to their capacity to improve the clarity of the law, increase its effectiveness, and improve community confidence. Clarification of the law serves to improve confidence in the provisions, which in turn promotes businesses' confidence in their legal position when dealing with consumers and other businesses. To the extent there is any defect of understanding about the effect of the provisions, that undermines confidence in them (or, worse, encourages action based on false confidence), and this can lead to inefficient decision making, misplaced expectations, and increased transaction costs.

Chapter 1, in combination with the material in Appendix B, has outlined of where the panel sees the law on unconscionable conduct as having reached, particularly during the time that has elapsed since section 51AC was introduced. While absolute certainty in every detail of every case cannot ever be achieved, there are a number of things about the interpretation of the provisions that can be said with some certainty. However, the breadth of opinion in the submissions provided to the panel concerning the effect of the provisions (or the effect some believe they *should* have) indicate that there may be opportunity to provide that clarity through some form of governmental or legislative action. The problem may also be characterised in terms of the intense policy debate that has surrounded unconscionable conduct for more than 30 years.

Statutory unconscionable conduct is a relatively sophisticated concept, and it is not a simple legislative expression of a 'fair go'.<sup>75</sup> It is not a 'legislative charter for judicial intervention whenever ethics dictate'<sup>76</sup>, and the underlying equitable doctrine 'is not one which extends sympathetic benevolence to a victim of undeserved misfortune'.<sup>77</sup> As Justice Deane noted in *Muschinski v Dodds*:

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72 See, for example, submissions from the Lottery Agents Association of Victoria and the Victorian Automobile Chamber of Commerce (VACC). Many of the confidential submissions provided to the panel are from aggrieved franchisees.

73 Mr Rod White of Yong Real Estate acknowledged the existence of unethical real estate practitioners, and Ms Madeleine Kingston outlined her concerns about the regulation of the energy industry.

74 Franchise Council of Australia submission, pages 3, 5-6; Speed and Stracey submission, page 1; CALC submission, page 2; SCCA submission, page 5; Trade Practices Committee of the Law Council of Australia (Law Council) submission, pages 6-7.

75 Minister Emerson articulated the problematic use of the 'fair go' principle in policy debates in Emerson, C, 'Freedom fair game in rules-obsessed culture', *The Australian*, 30 November 2009, page 16.

76 This was a concern articulated by the Cooney Committee in 1991, on page 108 of its report.

77 *Blomley v Ryan* (1956) 99 CLR 362 at 429, per Kitto J.

Under the law of this country ... proprietary rights fall to be governed by principles of law and not by some mix of judicial discretion ... subjective views about which party 'ought to win' ... and 'the formless void of individual moral opinion' ... [U]ndefined notions of 'justice' and what was 'fair' [have] given way in the law of equity to the rule of ordered principle which is of the essence of any coherent system of rational law.<sup>78</sup>

If the principles of law embodied in Part IVA of the TPA can be more clearly articulated, stakeholders (legally trained and otherwise) may be in a better position to understand the nature of unconscionable conduct as a 'coherent system of rational law'.

## A LIST OF EXAMPLES

The proposal for a list of examples was the first of the Senate Economics Committee's suggestions, and received the most analysis in the Committee's report, primarily because it was raised by a number of submissions to the inquiry. Similarly, the panel has received many submissions on this issue, often from the same stakeholders that previously indicated their support for the proposal.

It should be noted that some statutory regimes relating to unconscionable conduct or similar standards of conduct do contain examples as a means of clarifying the provisions. Section 36 of the *Tourism Services Act 2003* (Qld) contains a list of matters that may indicate unconscionable conduct, in a similar manner to the lists in sections 51AB and 51AC of the TPA. Some of the indicative matters are clarified by examples (of the endnote type) illustrating those matters. However, neither the matters nor the examples are exhaustive or presumptive in effect.

Support for a list of examples came primarily from small businesses and their representative bodies. Some submissions indicate their support for a list of examples based on their original support for the proposal during the Senate inquiry, or simply flagged their support before moving on to discuss other issues.<sup>79</sup>

The Queensland Newsagents Federation and the Newsagents Association of NSW & ACT (NANA/QNF) supported a non-exhaustive indicative list of examples that operated as rebuttable presumptions.<sup>80</sup> In weighing up the costs and benefits of this proposal, NANA/QNF considered that 'there are no real costs and only benefits of getting rid of offensive conduct'.<sup>81</sup> The Motor Trades Association of Australia (MTAA) expressed a near identical view, on the basis that it would put 'the onus on those who engage in what is usually unacceptable conduct to show why their conduct is necessary'.<sup>82</sup>

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78 (1985) 160 CLR 583 at 615-6 (citations omitted).

79 See for example, NARGA submission, page 1; Professor Zumbo submission, pages 7-8; COSBOA submission, page 2.

80 NANA/QNF submission, page 2. The submission suggests, in fact, that any allegation of unconscionable conduct should be presumed to be made out unless otherwise demonstrated.

81 *ibid.*

82 MTAA submission, page 2.



Several submissions saw the benefit of a list of examples as its effect on the behaviour of large businesses, particularly franchisors. The Lottery Agents Association of Victoria considered that incorporating the examples it suggested 'would certainly change the behaviour of a dominant franchisor'.<sup>83</sup> The Association's suggested examples are relatively specific, based on experience in its particular industry. VACC endorsed examples for a similar reason, and also suggested a range of examples from its industry perspective.<sup>84</sup>

This change in behaviour could come about as a result of increased community understanding of the provisions. Ms Geraldine Marburg noted that examples would:

provide people with an insight into real-world situations where unconscionable conduct can be demonstrated and improve people's general understanding ... If a good range of examples [is] included, it will increase people's ability to identify the behaviour correctly in other circumstances.<sup>85</sup>

## Risks

### Misapprehension

Professors Christensen and Duncan noted the risks associated with introducing a list of examples, particularly if the only reason for so doing would be to increase the understanding of the layman. Their submission raises the likelihood of 'misdiagnosis' by those reading examples in the legislation. A finding of unconscionable conduct is dependent on the specific facts and circumstances before the court, and the professors point to two recent unconscionable conduct cases with similar factual scenarios (refusal to negotiate renewal of leases) which were decided differently due to different surrounding circumstances.<sup>86</sup>

Examples, which by their nature are explanatory and not determinative, may not achieve certainty in the law, but might create a false sense of expectation in those who read them. It is easy to imagine small business owners who feel hard done by in their transactions with larger businesses, reading the examples of unconscionable conduct and adopting the view that their specific circumstances match one of them. This could lead many to invest significant resources in terms of time, effort and money in pursuing a case, only to discover that a court, in considering the particular circumstances, finds that the conduct is not unconscionable.

This misapprehension is also capable of distracting disputing parties from the core elements of their disputes. If a party believes another's conduct falls within an example of unconscionable conduct, but the other does not, this is likely to be a source of legal dispute. However, the dispute is better resolved by concentrating on whether the conduct of the other party was, in all the circumstances, unconscionable. A collateral debate about whether a party's conduct matches an example is not likely to facilitate dispute resolution.

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83 Lottery Agents Association of Victoria submission, page 1.

84 VACC submission, pages 2-3.

85 Ms Geraldine Meiburg submission, page 1.

86 Professors Christensen and Duncan submission, pages 1-2. The recent cases were *Australian Competition and Consumer Commission v Dukemaster Pty Ltd* [2009] FCA 682 and *Murphy v Freemantle Markets Pty Ltd* [2009] WASAT 84.

## Rebuttable presumptions

The problems identified above are just as likely to arise if the examples are cast as rebuttable presumptions. If a presumption is to be rebutted, it will be rebutted by reference to the law of unconscionable conduct as it has already developed. The lay reader of the TPA is no better prepared for that when the examples are presumptions than when they are merely illustrative. It may still be the case that the conduct is not, in all the circumstances, unconscionable. Rebuttable presumptions are not a simple solution to the difficulties of evaluating whether conduct is, in all the circumstances, unconscionable. Presumptions do not overcome that difficulty; nor do they assist the weaker party to grapple with it or avoid it. They may initially assist the weaker party in making a case, however, courts would still need to grapple with the question of whether the conduct is unconscionable in all the circumstances.

The panel received submissions supporting a list of examples that operate as rebuttable presumptions.<sup>87</sup> However, it would be a significant regulatory shift to require businesses to prove their actions were not unconscionable wherever it was alleged their conduct matched a statutory example. This is particularly so given the fact-dependent nature of unconscionable conduct, where conduct that is not unconscionable might regularly match one of the examples, requiring recourse to the general law to demonstrate that, *in all the circumstances*, the conduct was not unconscionable. The panel is not persuaded that a sufficient basis exists on the evidence before the panel to justify shifting the onus away from parties alleging unconscionable conduct.

There are also practical difficulties with formulating rebuttable presumptions of unconscionable conduct, particularly if the listed factors in section 51AC are to be recast as presumptions. It will not always be obvious whether the criteria established by a presumption are met. For example, one factor refers to what is 'reasonably necessary for the protection of ... legitimate interests', and this is not a simple criterion which may be assessed with certainty in any particular case.

Further, casting the factors as rebuttable presumptions may indicate that when conduct of a kind described by one factor is engaged in, the conduct is therefore unconscionable unless it can be proved otherwise. Conduct must be unconscionable in all the circumstances to be caught by the provisions, and simply placing a tick next to one of the factors does not necessarily indicate that the conduct is unconscionable in all the circumstances. It is not impossible that conduct that meets one of the factors would be found to be unconscionable – for example, bad faith business behaviour could, in certain circumstances, be found to be unconscionable. However, such a finding remains dependent on an analysis of 'all the circumstances', and the existence of another factor might, in fact, mitigate the existence of the other.

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87 NANA/QNF submission, page 2, Professor Zumbo submission, pages 7-8, MTAA submission, page 2, Mr Redfern submission, pages 1-2 and ANF submission, page 2 specifically argue this point, as do a number of confidential submissions. The point may also be inferred from the position taken in some submissions, such as NARGA submission pages 1-2.



## Practical constraints and ripple effects

A key risk in developing a list of examples of unconscionable conduct lies in ensuring the list is comprehensive and that it does not hinder or alter the application of the provisions in practice.

The panel has been asked to look at unconscionable conduct as it is understood in the context of the TPA. It is likely any reforms resulting from the panel's findings may affect the provisions of the ASIC Act with respect to financial services.<sup>88</sup> The panel is mindful of the effects of a list of examples on the financial services industry. This is in addition to the interests of the retail tenancy and franchising industries, which are specifically identified in the panel's terms of reference.<sup>89</sup> These are three significant and diverse industries, but they do not set the bounds of the necessary inquiry. Unconscionable conduct can arise in any industry, and it is not possible to cover this field through a list of examples. As Mr David Wright noted, 'if there is one thing that law proves again and again, [it] is that novel fact situation[s] will arise'.<sup>90</sup>

It is because novel factual circumstances will always arise that a general prohibition is best suited to addressing undesired conduct of this kind, in much the same way as section 52 creates a general prohibition of misleading conduct. It is not possible to canvass in a statute all the circumstances which may lead to conduct being misleading in any given industry or in the entire business environment. The general prohibition creates a norm of conduct which must be followed by businesses, without pointing to particular examples of what might constitute a breach of that norm.

There are important reasons for this. One is that, as has been alluded to, it is difficult – if not impossible – to do justice to the task of listing examples when there are so many different potential factual circumstances to be addressed, and so many industries within which unconscionable conduct may occur. Any list of examples would not be complete or comprehensive sufficient to make it practically useful in legislation. Additionally, what may be unconscionable in one industry may not be unconscionable in another, depending for example on the expectations of industry participants or the reasonableness of certain business models (such as unilateral variation of contract terms).

Unscrupulous businesses may also have incentives to distort their conduct to avoid the precise behaviour specified by the examples. Where this occurs, the examples do nothing to assist in finding unconscionable conduct to have occurred in the distorted circumstances, and may in fact lead many stakeholders (including small businesses) to conclude that the conduct is not unconscionable because it is not covered by an example.

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88 There has been no indication that the apparent policy of mirroring amendments in the ASIC Act would be discontinued. The *Trade Practices Legislation Amendment Act 2008*, for example, amended both Part IVA of the TPA and Part 2, Division 2, Subdivision C of the ASIC Act. Moreover, the Government response to the Senate Economics Committee inquiry commits to making mirror amendments in the TPA and ASIC Act to give effect to Recommendation 1.

89 At least some state retail leasing laws (such as those in NSW) mirror the provisions of section 51AC).

90 Mr Wright submission, page 1.

Further, a list of examples is not likely to remain current. Community expectations change, and with them change the understanding and, in effect, the meaning of unconscionability. For this reason, the Motor Trades Association of Queensland suggested the list of examples 'should be a living document', subject to change over time, and incorporating a 'register of serious complaints' which would give publicity to disputes.<sup>91</sup> VACC also noted the need for the list of examples to be a 'live document', which could be 'amended to add and subtract information that will assist with the objectives of the laws'.<sup>92</sup>

The panel considers these to be legislatively and administratively burdensome proposals, and prefers a more flexible model which would not require a constant stream of amendments. It is worth noting that the prohibition of misleading or deceptive conduct in the TPA has been amended only once, to address a minor, technical point.<sup>93</sup>

At the same time, there is a difference between embedding examples of unconscionable conduct in legislation and referencing them in regulatory guidance and educational material from the ACCC and other regulators. The panel received submissions supporting the need for regulatory guidance and public awareness-raising.<sup>94</sup> Indeed, such guidance will be essential when civil penalties are introduced, to provide the community with an understanding of the regulators' approach to the provisions and the use of penalties.

#### Limiting the development of the provisions

Another reason for a general prohibition without examples concerns the development of the interpretation of the provision by the courts. Many submissions point to a judicial tendency to reading examples as though they limit the scope of the provisions they exemplify.<sup>95</sup> This may be particularly the case in lower courts or tribunals, where decision-makers may be reluctant to step outside the bounds of the examples.

Some submissions recognise this possibility, and emphasise the importance of ensuring the examples are not taken to limit the generality of the provision.<sup>96</sup> However, examples may have this effect even where expressions such as 'without in any way limiting the generality of' the relevant provisions are used. The mere presence of examples may serve as an indication that Parliament has considered the issue and is setting the general bounds of the provision. If examples are to provide legislative guidance, then it is not unreasonable to assume the guidance they provide is as complete as possible. And yet, as has already been discussed, completeness in this area would be a Sisyphian task.

A list of examples could not hope to anticipate ahead of time future developments in the law, raising the possibility that unanticipated developments simply would not occur on the basis

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91 Motor Trades Association of Queensland submission, pages 6, 8.

92 VACC submission, page 4.

93 The *Trade Practices Amendment Act 1977* added conduct that 'is likely to mislead or deceive' to the scope of the prohibition.

94 See, for example, Franchise Council of Australia submission, page 9.

95 SCCA submission, pages 2-4; IAG submission, page 2; Law Council submission, page 5-6; Australian Institute of Credit Management submission, page 3. The Association of Consulting Engineers Australia makes a similar point about the narrow scope of examples (on pages 1-2), but also considered that a list of examples could be beneficial in eradicating specific practices from the market place.

96 VACC submission, page 3.

that they are not addressed in the examples. The Trade Practices Committee of the Law Council of Australia (Law Council) noted that there was significant uncertainty about the effect of section 52 when it was introduced into the TPA. Many of the developments since then may not have been predicted at the time – for example, the notion that silence can in some circumstances be taken as misleading.<sup>97</sup> If in 1974 Parliament had included a list of examples of misleading or deceptive conduct, it is possible that the point about silence may have been overlooked. A court faced with an extensive statutory list of examples of misleading conduct that did not include silence, either expressly or by implication, is likely to be less inclined to find silence misleading than is a court faced with a simple, general prohibition.

#### A definition of unconscionable conduct

In considering the proposal for a list of examples, a number of submissions propose – either expressly<sup>98</sup> or by implication from the examples proposed and their suggested effect – to *define* unconscionable conduct. The Government has already decided not to define unconscionable conduct in the TPA, endorsing the Senate Economics Committee’s findings to that effect.

As is discussed below with respect to a statement of principles, there are different types of principles which may be used in legislation: some an aid to statutory interpretation, some indicating generally appropriate conduct. Similarly, examples may be cast as explaining the effect of the law, or as defining the scope of acceptable business conduct. Examples of the latter kind would have substantively the same effect as the approach implicitly rejected by the Senate Economics Committee and the Government in not endorsing a definition. The panel has been asked to consider examples that clarify and explain the effect of the unconscionable conduct provisions.

#### Per se offences

The Australian Newsagents Federation (ANF) also acknowledged the risk that examples may narrow the scope of the provisions, and warned that a list of examples alone may have this effect. The ANF therefore recommended the introduction of per se prohibitions, which ‘would provide a clear understanding of proscribed kinds of conduct ... [and allow] for the gradual expansion of the scope of the legislation in line with the development of the equitable concept of unconscionable conduct’.<sup>99</sup>

If there are to be per se prohibitions of certain conduct in the TPA, that is a policy decision for the Government that must be made with respect to each particular proposed prohibition. Certainly, even if it were open to the panel to consider this option under its terms of reference, it has not received evidence of any particular conduct sufficient to recommend such prohibitions. The panel also notes that Part V of the TPA prohibits specific conduct. These provisions have been reviewed in the development of the ACL, and a range of other

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97 Law Council submission, page 4.

98 Professor Zumbo submission, pages 5-6; Retail Traders Association of Western Australia (RTAWA) submission, page 2; and Post Office Agents Association submission, pages 2-3.

99 ANF submission, page 2.

prohibitions drawn from best practice in state and territory laws will also be introduced into the ACL.<sup>100</sup>

### Content of the examples

In recommending further consideration of the option of including examples of unconscionable conduct in the TPA, the Senate Economics Committee framed its recommendation in terms of the possibility of compiling ‘a list of clear examples, *that all parties agree* constitute “unconscionable conduct”’.<sup>101</sup> The Committee suggested as an illustration that industry and sectoral stakeholders might come together to try to reach a baseline of standard-setting on unconscionable conduct.<sup>102</sup> No such consensus emerges from the series of individual submissions received by the panel, or from the material provided to the Committee. In forming its own recommendations about examples of unconscionable conduct in the law, the panel is mindful of both the Committee’s concept of examples and the degree of difference of opinion reflected in the submissions to this inquiry.

### Conclusion

The panel does not recommend the introduction of a list of examples, for the reasons set out above. However, useful examples of unconscionable conduct are continually generated through the enforcement activities of the regulators, and through the results of private actions for unconscionable conduct. As discussed later in this chapter, it is important for regulators to develop effective guidance material on the unconscionable conduct provisions. The panel considers that this regulatory guidance material is the most appropriate place for examples of unconscionable conduct, drawn from the results of enforcement activity. Unlike examples entrenched in legislation, examples in guidance material more easily maintain an ongoing currency, and can be provided in a medium that allows the examples to be explained more completely, with regard to all the circumstances in which they were generated.

Furthermore, on balance, the panel considers that the costs (including compliance costs) associated with introducing a list of examples into the law at this stage of its development outweigh any benefits of doing so, and that even if a list of examples could be endorsed conceptually, it would be too difficult to compile a list in practice that caters for all industries and all circumstances, while leaving scope for the development of the law.

The panel received many submissions outlining what stakeholders considered to be examples of unconscionable conduct; sometimes expressed generically, sometimes based on the particular experiences of the stakeholder’s industry. The panel thanks those stakeholders for their assistance in providing this information to inform its deliberations and to bring home to the panel the real ways in which stakeholders feel they are experiencing the effect and limits of the current law of unconscionable conduct. However, given the panel does not endorse the introduction of a list of examples, it does not propose to examine these examples

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100 For more on this process visit [www.treasury.gov.au/consumerlaw/](http://www.treasury.gov.au/consumerlaw/).

101 Page 44 of the Committee’s report.

102 Pages 37-8 of the report.

in detail or express any views about whether or not they in fact constitute (or should constitute) unconscionable conduct.

## A STATEMENT OF PRINCIPLES

Different submissions have taken differing views as to what is meant by a ‘principle’, or what should be the effect of a principle if included in the legislation. Some have suggested principles that indicate what appropriate behaviour from a business might be, where there may or may not be strict legal consequences should a business not comply with that behaviour.<sup>103</sup> Alternatively, principles may be a guide to interpretation of the provisions, serving as signposts for identifying unconscionable conduct.<sup>104</sup> Principles of this kind may or may not be mandatory considerations.

The panel prefers the view of principles as interpretative principles, assisting the courts and other stakeholders in interpreting the provisions. Principles of business conduct are closer to examples, which the panel has already examined. Guiding principles of interpretation provide an indication of the law’s effect without unduly confining the law’s development.

### Mandatory considerations

Some of the problems associated with a list of examples potentially apply also to the model of ‘principles’ proposed to the Senate Economics Committee, which would operate as mandatory considerations or rebuttable presumptions.<sup>105</sup> Such a model carries risks of limiting judicial discretion and narrowing the focus of the provision. Additionally, if any mandatory considerations were based on the existing statutory factors,<sup>106</sup> the legislation would require courts to consider factors that may have nothing to do with the case at hand. For example, if there are no documents relating to a transaction, there may be little to be gained by asking courts to confirm explicitly that they have considered whether the business consumer or supplier was able to understand any documents. One stakeholder considered that there may be a danger that principles which are mandatory considerations would simply ‘create plenty of additional ballast’ in legal disputes.<sup>107</sup>

Insurance Australia Group (IAG) stated that it ‘does not believe that a mandatory set of principles better supports interpretation of the TPA in relation to unconscionability than the discretionary factors that are currently available’.<sup>108</sup> Much has been made by some stakeholders of the fact that consideration of the factors is not mandatory, and courts may ignore them if they so choose.<sup>109</sup> Through sections 51AB and 51AC, Parliament has given the courts a list of matters to which they may have regard. Parliament has not insisted that each factor *is* relevant to a finding of unconscionable conduct, because it is impossible for

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103 Principles of this kind were proposed by the RTAWA pages 2-3.

104 See, for example, MTAA submission, pages 3-4.

105 See the discussion of this model on pages 13-4 of the issues paper.

106 as suggested by the ANF (at page 4) and a confidential submission.

107 Abacus submission, page 5.

108 IAG submission, page 2.

109 See, for example, MTAA submission, page 2.

Parliament to know ahead of time whether any factor will be relevant or even if it will exist in the context of any particular case that comes before the courts.

For these reasons, the panel does not support a statement of principles that operate as mandatory considerations. Rather, it has focused on the alternative kind of a statement of principles discussed in the issues paper, where the statement is an aid to statutory interpretation, consistently with other ways in which the TPA already provides ‘guiding principles’ for interpretation, in particular Parts of the Act and in the Act’s stated purposes as a whole.

### Principles of interpretation

Submissions canvassed some kinds of principles but not others. More than one submission in favour of reform links principles to rebuttable presumptions and sometimes to reversals of the onus of proof, so that particular conduct would automatically be judged unconscionable once it was found to exist, unless the party engaging in that conduct proved otherwise. Some submissions demonstrate lingering tensions between how the law in this area is designed and interpreted in regulatory and judicial quarters and how it is perceived by some industry stakeholders – a factor that itself points to the possible need for principles of interpretation that clarify the legal position for all, by at least confirming and crystallising what is both evident and latent in the structure of Part IVA and its judicial interpretation.

Some submissions indicated qualified support for a statement of principles in terms of having no objection to the proposal.<sup>110</sup> As discussed previously, the panel considers the problem that needs addressing is the lack of clarity and certainty surrounding the intention and effect of statutory unconscionable conduct, and its scope. This problem is most appropriately addressed through interpretative principles and a clearer statement about the intention, effect and scope of Part IVA, particularly sections 51AB and 51AC.

The interpretative principles are designed to ensure that courts treat statutory unconscionable conduct as expansively as was intended. This intention may be summarised as extending unconscionable conduct (at least in section 51AB and 51AC) beyond the principles developed by common law and equity. The principles would be ‘mandatory’ in the sense that they would evidence Parliament’s clear intention as to the manner in which the provisions are to be interpreted.

While the issues paper discussed an ‘objects clause’<sup>111</sup> as a vehicle for introducing principles, the panel did not receive submissions specifically supporting such an arrangement. Should the Government choose to introduce a statement of principles, it may wish to consider whether it would be assisted by an objects clause, in the light of similar clauses existing in the TPA.

Interpretative principles would provide stakeholders with a clearer understanding as to the scope of Part IVA. In the following section, the panel suggests introducing principles of

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110 Professors Christensen and Duncan, page 6; Law Council submission, page 5.

111 similar to the operation of section 44AA for Part IIIA of the TPA.



interpretation which dovetail closely with the directions in which the law seems to be settling in the courts. However, that these principles are becoming settled is not reason to think that no legislative clarification is necessary. A law that generates as much disagreement about its meaning, application, and adequacy as that revealed by the submissions is at least a candidate for further clarification.

### Content of the principles

Some submissions, which expressed caution about a possible statement of principles, indicated support for its introduction providing it did not stifle the development of the law, and, to achieve this end, it would be best that the principles be drawn from existing case law. The Franchise Council of Australia, which is opposed to the introduction of a statement of principles, nonetheless observed that principles may be derived from the body of case law that has developed under the provisions.<sup>112</sup> VACC implied that the principles should be drawn from existing 'TPA laws', as this will minimise any compliance costs.<sup>113</sup> The Law Council indicated that, '[n]aturally, the Committee's view is that any statements of principles should be consistent with concepts of unconscionability put forward in *Attorney-General (NSW) v World Best Holdings Limited*'.<sup>114</sup>

Other stakeholders suggested that the principles should direct the court's attention to conduct which may not in the past have been considered unconscionable. For example, the MTAA submission (and the NANA/QNF submission) indicates support for principles 'which recognise unequal bargaining positions, the need to consider the impact of conduct on the other party and so on'.<sup>115</sup> The suggestion that the stronger party should, in effect, consider the best interests of the weaker party, and act to mitigate the weaker's losses (on the basis that 'the party engaged in the conduct will usually be better able to bear any loss'<sup>116</sup>), would transform unconscionable conduct into something closer to a fiduciary duty.

The Senate Economics Committee and the Government took great pains to preserve the operation of Part IVA as based on the pre-existing equitable principles<sup>117</sup>, and to clarify, rather than substantially alter, its effect. Moreover, as Professors Christensen and Duncan noted, principles 'which lower the standard to one of fairness and justness would dilute the concept and create an avalanche of claims ... in addition to overtaking the proposed unfair terms provisions of the Australian Consumer Law'.<sup>118</sup> Further, framing principles in such a way could unfairly raise the expectations of small businesses that they will always have access to a remedy when another party engages in conduct they consider to be unfair, without reference to the legal effect of the provisions. Therefore, the panel agrees that

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112 Franchise Council of Australia submission, page 17. The Council indicates that the fact principles may be derived from the existing body of case law is reason not to introduce those principles into legislation.

113 VACC submission, page 4.

114 Law Council submission, page 5. As discussed in Chapter 1, the panel considers *World Best Holdings* and *National Exchange* as together providing the best representation of recent jurisprudence on statutory unconscionable conduct in intermediate appellate courts.

115 MTAA submission, page 3. See also NANA/QNF submission, page 3.

116 *ibid.*

117 See the Government's response to Recommendation 1 of the Committee's report, on page 3.

118 Professors Christensen and Duncan submission, page 6.

principles of interpretation drawn from the development of the law to date would be the most useful statement of principles to include in the legislation.

Naturally, the content and drafting of any statement of principles is a matter for the Government. In drawing the recommended principles together, the panel has had regard to its analysis of the law, the submissions it has received and, in particular, input from the ACCC and the Australian Securities and Investments Commission (ASIC).

#### **The statute is not limited to equitable and common law doctrines**

The panel recommends an interpretative principle in the ACL indicating that statutory unconscionable conduct, within the meaning of section 51AC (and, arguably, section 51AB<sup>119</sup>), is not limited to the scope of the equitable and common law doctrines of unconscionability.<sup>120</sup>

Section 51AA draws directly on the equitable and common law doctrines of unconscionable conduct. Sections 51AB and 51AC draw on the doctrines only indirectly, as the basis for the legislative action, but these provisions are not limited to the scope of ‘the unwritten law’. The equitable and common law doctrines may continue to develop (as indicated by the expression ‘from time to time’ in section 51AA), but so too may statutory unconscionable conduct develop, and (where appropriate) develop independently from the equitable and common law doctrines.

The extrinsic material associated with section 51AC clearly indicates that the provision should build on existing case law concerning unconscionability. But it does not indicate that the statutory unconscionable conduct provisions should be kept tied to that existing body of common law, and in the panel’s view that material cannot be read as intending to confine the provisions to that body of law. The material simply indicates that the provisions are not structured to reach conduct that is merely ‘unfair’, for the reasons well explained by Chief Justice Spigelman in *World Best Holdings*.<sup>121</sup>

#### **Courts may examine the terms and progress of a contract**

The panel recommends an interpretative principle indicating that courts, in examining conduct alleged to be unconscionable, may examine the terms and progress of a contract. This principle would echo, and emphasise, the amendment to which the Government has already agreed. That is, the amendment to recognise that the terms and progress of a contract may be relevant to a finding of unconscionable conduct.

The Government has cast this amendment as addressing concerns about ‘substantive unconscionability’ (conduct associated with the terms of a contract or the behaviour of the parties in carrying it out), which some believe to have been ignored in favour of ‘procedural

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119 See the discussion in *Australian Competition & Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253 at 264-7, per Sundberg J.

120 A similar principle was recommended by Mr David Wright on page 1 of his submission.

121 *Attorney-General (NSW) v World Best Holdings Ltd* (2005) 63 NSWLR 557 at 583.



unconscionability'.<sup>122</sup> A plain reading of the factors in sections 51AB and 51AC makes it clear that issues associated with the contract itself and the behaviour of parties pursuant to the contract are already implicitly relevant to statutory unconscionable conduct.<sup>123</sup> As one commentator has noted, since the list of factors 'contain both procedural and substantive elements, [the provisions] allow the court to look at both bargaining practices and outcomes'.<sup>124</sup>

Consistent with the clarifying amendment the Government has already announced, this principle would simply make clear that the unconscionable conduct provisions can apply to the terms and progress of agreements, not just to their formation.

### The provisions may apply to systemic conduct or patterns of behaviour

Chapter 1 discussed the recent outcome of ACCC enforcement action against *Craftmatic*. In its section 87B undertaking, Craftmatic 'acknowledges the ACCC's concerns' that:

the sales method designed and implemented by Craftmatic led to a systematic exploitation of its customers, typically elderly persons, which in all of the circumstances amounted to unconscionable conduct in contravention of section 51AB of the Act.<sup>125</sup>

This illustrates that a system of conduct or pattern of behaviour may be unconscionable, and that statutory unconscionable conduct is not limited to an examination of particular transactions.

It is important to incorporate this principle in any legislative statement. It allows regulators, in particular, to address systemic exploitative conduct as being itself unconscionable. To quote from Justice Kitto's reasoning in *Blomley v Ryan*, the concept of unconscionability 'is not one which extends sympathetic benevolence to a victim of undeserved misfortune; it is one which denies to those who act unconscientiously the fruits of their wrongdoing'.<sup>126</sup> It is therefore to the wrongdoing that one must look, not necessarily or solely to the transaction with the victim of undeserved misfortune.

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122 Some submissions (in particular Competitive Foods, page 3) speculated as to whether the scope of the amendment encompasses end-of-term issues. The Government has not yet introduced its amendments into Parliament.

123 For example, the factors include reference to the price specified by contract, any unilateral variation clauses, documents associated with the supply or acquisition (which must surely include the contract itself), and so on.

124 Brown, L, 'The impact of section 51AC of the *Trade Practices Act 1974* (Cth) on commercial certainty' (2004) 28 *Melbourne University Law Review* 589-622, page 600. However, this view is not universally accepted. See, for example, Strickland, P, 'Rethinking unconscionable conduct under the Trade Practices Act' (2009) 37 *Australian Business Law Review* 19-49, page 22.

125 *Trade Practices Act 1974: Undertaking to the Australian Competition and Consumer Commission given under section 87B by Craftmatic Australia Pty Ltd*, pages 1-2. The undertaking is available on the ACCC's website, [www.accc.gov.au](http://www.accc.gov.au).

126 (1956) 99 CLR 362 at 429.

## The identification of a special disadvantage is not necessary to attract the application of the provisions

It follows from the change of focus on the transaction to the conduct itself that the nature of the ‘victim’ diminishes in importance. As the Full Federal Court noted in *ASIC v National Exchange*, section 12CC of the ASIC Act (and section 51AC of the TPA) are not confined by ‘limitations from the unwritten law, such as the necessity to identify a specific or particular person’.<sup>127</sup>

The understanding of unconscionable conduct drawn from *Amadio* relies on the identification of a party who ‘by reason of some condition [or] circumstance is placed at a special disadvantage vis-à-vis another’.<sup>128</sup> However, section 51AC (and, arguably, section 51AB<sup>129</sup>) does not rely on that identification<sup>130</sup>, since it is directed at the *conduct* which is, in all the circumstances, unconscionable.

Establishing that a person is at a special disadvantage may be sufficient, but is not a necessary condition for access to the provision. The question, rather, is whether a party has done ‘what should not be done in good conscience’<sup>131</sup>, or has engaged in conduct attracting ‘a high degree of moral obloquy’.<sup>132</sup> Depending on the circumstances before the court, this question may not raise the issue of whether a special disadvantage exists.

Therefore, the panel recommends an interpretative principle indicating that the identification of a special disadvantage is not necessary to attract the application of section 51AC (and, arguably, section 51AB). Whether the issue of special disadvantage arises remains a question to be determined by the courts.

## OTHER OPTIONS

The issues paper canvassed other options for addressing the want of clarity in statutory unconscionable conduct. Although an appropriately drafted statement of principles would go a considerable way to addressing this problem, a statement alone would not be a complete answer to the problem. Therefore, there is merit in examining the other options discussed in the issues paper, as well as the possibility of unifying the statutory unconscionable conduct provisions.

### Guidance from regulators and others

There is widespread support for the development of further guidance concerning the unconscionable conduct provisions. As the Franchise Council of Australia noted, it is ‘self-evident that education is the key to understanding’.<sup>133</sup> A means of addressing

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127 (2005) 148 FCR 132 at 140.

128 (1983) 151 CLR 447 at 462, per Mason J. Appendix B discusses the development of the concept of ‘special disadvantage’ to encompass both personal and situational disadvantage.

129 See *ACCC v Simply No-Knead*.

130 As demonstrated by the *Craftmatic* scenario.

131 *ASIC v National Exchange* (2005) 148 FCR 132 at 140.

132 *Attorney General of NSW v World Best Holdings Ltd* (2005) 63 NSWLR 557 at 583, per Spigelman CJ.

133 Franchise Council of Australia submission, page 9.

stakeholder understanding of the provision is to ensure that comprehensive information about the provisions is readily available to the public.

Responsibility for enforcing statutory unconscionable conduct rests with the ACCC, ASIC and the state and territory consumer regulators. To the extent that the consumer regulators will enforce the new ACL, they will also enforce business-to-business unconscionable conduct through the ACL's equivalent of section 51AC of the TPA. This will be a novel state of affairs for many of the regulators, who do not currently have this responsibility. Moreover, it will be a novel experience for businesses in those jurisdictions that have not hitherto had a state-based business-to-business unconscionability law.

In practice it is likely that the bulk of unconscionable conduct enforcement will be carried out by the ACCC and ASIC. However, all regulators will be empowered to act, under the 'one law, multiple regulators' model adopted for the ACL, and consequently it is important that the community receive guidance from all regulators about the nature of unconscionable conduct and what, in their view, will be seen as sufficient grounds to take action. As the law will be the same in each jurisdiction, it makes sense for this guidance to be uniform across jurisdictions. Therefore, the panel considers that the ACCC, ASIC, and state and territory regulators should develop uniform national guidance relating to statutory unconscionable conduct.

The panel acknowledges the wealth of detail in the regulators' current publications on unconscionable conduct. However, there is scope for this material to be made more robust, to assist community understanding of the provisions. As the MTAA put it, the guidance would benefit from being 'less qualified and less cautious' than it currently is.<sup>134</sup> While it is important not to overstate the law, there is a danger in providing cautious guidance that it will not achieve its end in improving stakeholder understanding. An analysis of the history of the provisions and recent illustrative cases is important, but so too is an indication of what the regulator understands to be unconscionable conduct, and in what circumstances it will act. This should be provided not to raise expectations of regulator action unreasonably, but to make regulator decision-making processes more transparent. An understanding of this decision-making process will become increasingly important following the introduction of penalties and enhanced enforcement arrangements for the provisions.

National guidance may include not only the circumstances in which the regulators will exercise those powers and the factors affecting their exercise, but also examples of what has been considered to be unconscionable conduct based on all of the investigations, proceedings, settlements and undertakings in which they have been involved. Importantly, this material should refer to any interpretative principles the Government chooses to introduce, to highlight their effect on the interpretation of the provisions.

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134 MTAA submission, page 4.

This is consistent with an ongoing emphasis on the provision of regulatory guidance<sup>135</sup>, as a means both of educating the community about the law and of identifying the extent of particular problems. An example of this latter function is the Government's announcement that it:

supports the public release of broad ACCC data on trends of inquiries and complaints from small businesses and franchising businesses as an indicator of concerns within the franchising sector as compared with small businesses more generally ...

The Government will also ask the ACCC to develop additional educational information on the potential consequences and liabilities franchisees could be exposed to in the event of franchisor failure.<sup>136</sup>

### Test cases

The bringing of further test cases will be important in developing national guidance on this issue. Test cases are, in fact, examples of unconscionable conduct, and publicising these cases will bring greater community understanding of the provisions. In particular, given the changes that have already been announced, and any changes the Government might pursue arising out of this report, the new provisions would benefit from appropriate test cases being brought, and reported through guidance material.

The panel notes that the Government has already indicated its support for more test cases, in its formal response to the Senate Economics Committee report. The Government noted the ACCC's 'renewed determination' to bring test cases, and encouraged the ACCC to continue in its resolve to achieve further judicial guidance on unconscionable conduct under the TPA.<sup>137</sup> An increase in test case activity will facilitate more accurate regulatory guidance and educative material, improved awareness of compliance issues and effectiveness of compliance training, and will provide valuable empirical research to augment understanding of the effect of the provisions and inform evidence-based review. The importance of research of this type is discussed in greater detail in Chapter 4.

### Unified provisions

The issues paper discusses the possible variation between sections 51AB and 51AC of the TPA.<sup>138</sup> Both are intended to expand the scope of the prohibition to conduct that is 'in all the circumstances' unconscionable, rather than conduct that is unconscionable within the probably more restrictive 'meaning of the unwritten law, from time to time, of the States and

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135 See, for example, the guidance issued recently by the ACCC with respect to the 'clarity in pricing' amendments to section 53C of the TPA, 'New pricing requirements clarified' (media release, 6 May 2009) and the introduction of unit pricing in supermarkets, 'ACCC issues guides on unit pricing for grocery retailers' (media release, 1 July 2009).

136 Government response to the Joint Committee inquiry, page 6.

137 Government response to the Senate Economics Committee inquiry, page 5.

138 See pages 6-8 of the issues paper, and in particular page 8.

Territories'. It has been said that it would be 'curious' if the two provisions gave different meanings to the same phrase.<sup>139</sup>

And yet, different factors are specified in each provision as being potentially relevant to a contravention, and the list of factors is more expansive in section 51AC than in 51AB. The Senate Economics Committee noted the view that this makes section 51AC a more 'workable approach' to addressing unconscionable conduct, 'broader than section 51AA and better defined than section 51AB'.<sup>140</sup> Professor John Carter noted that, although the factors are different, 'those differences cannot be accounted for in any discernable scheme'.<sup>141</sup>

Several submissions supported unifying the provisions governing statutory unconscionable conduct.<sup>142</sup> While not addressing the possibility of unifying the provisions, CALC noted that section 51AC was based on section 51AB, and that if changes were made to the business-to-business provision that could make the general meaning of statutory unconscionable conduct less clear in consumer contexts, which would be a problematic outcome.<sup>143</sup>

The panel shares CALC's view of the dangers of the law of unconscionable conduct diverging with respect to businesses and consumers, particularly if that divergence ultimately provides greater protections to businesses than consumers. Further, the panel notes that its preferred 'statement of principles' would apply to both statutory unconscionable conduct provisions, emphasising the coherence of principle between the two.

Consequently, the panel supports examining the possibility of harmonising or unifying the two provisions. The provisions will soon be incorporated into the ACL. The process of introducing the provisions into the ACL may provide an opportunity to update section 51AB to harmonise its effect with section 51AC. The panel does not propose a review of the factors in these sections; nor does it recommend that the factors need be extended or curtailed. Rather, the panel simply suggests that there may be scope to harmonise the provisions in this respect.

## Undertakings

The issues paper discussed the increased and better use of section 87B undertakings as an alternative or additional means of reducing the incidence of unconscionable conduct. Section 87B allows the ACCC to accept a written undertaking from a person, which then becomes enforceable in a court. ASIC has access to a similar mechanism under section 93AA of the ASIC Act.

SCCA noted that this proposal could be seen to be 'at odds' with the Government's response to the Senate Economics Committee report, which encourages the ACCC to pursue further

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139 *Australian Competition & Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253 at 265-6, per Sundberg J.

140 Page 5 of the report.

141 Freehills submission, page 3.

142 See, for example, Mr David Wright submission, page 2; Professor Zumbo submission, page 4.

143 CALC submission, page 2.

test cases. SCCA considered that, at any rate, 'it is for more sensible to encourage the ACCC to reach settlements, including accepting section 87B undertakings, and thus quickly reach relief for the aggrieved party'.<sup>144</sup>

However, it may not always be the case that early termination of a matter through a section 87B undertaking stifles the opportunity for informative enforcement action. As the *Craftmatic* enforcement action demonstrates<sup>145</sup>, the use of section 87B undertakings (often in conjunction with court proceedings and consent orders) can provide an important and useful insight into the development of the law. This is particularly the case when the ACCC takes an active interest in publicising the undertakings. While the ACCC regularly issues media releases when it has accepted significant undertakings, in the panel's view more could be done to highlight the importance of this mechanism and the outcomes of its use.

Nevertheless, the ACCC has indicated its willingness to take more section 51AC test cases 'to the full extent', while taking account of opportunities to settle matters before they reach final judgment.<sup>146</sup> The panel notes that section 87B undertakings are an important regulatory tool and do usefully provide guidance on statutory unconscionable conduct.

### Industry codes

The panel notes the Government's recently announced intention to review and replace the policy documents related to industry codes of conduct prescribed under the TPA.<sup>147</sup>

As several stakeholders<sup>148</sup> and previous reviews<sup>149</sup> have suggested, industry-specific problems deserve industry-specific solutions rather than changes to the generic law which, if ill-considered, operate indiscriminately across industries and can harm business certainty for the whole of the economy. At the same time, this is not a reason for pursuing industry-specific regulation at all costs when there are widespread problems to be addressed and the generic law is suited to the task.

### Retail tenancy

In terms of industry-specific problems, the panel notes that its terms of reference include a requirement to consult specifically with the retail tenancy industry. This industry has been the focus of many fair trading reviews, and of many unconscionable conduct cases<sup>150</sup>, and it is not surprising then that it should have formed part of this process.

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144 SCCA submission, page 7.

145 Discussed in Chapter 1.

146 Senate Economics Committee, Parliament of Australia, Sydney, Monday 3 November 2008, page E9 (Mr Scott Gregson, General Manager, Coordination, Enforcement and Compliance Division, ACCC).

147 See the Government response to the Joint Committee report, page 10.

148 SCCA submission, page 8; Professors Christensen and Duncan submission, page 8; Franchise Council of Australia submission, pages 3, 5; Speed and Stracey submission, page 1; CALC submission, page 2; Abacus submission, page 6; IAG submission, page 2; Pharmacy Guild of Australia, page 3. Stakeholders differed as to whether industry codes were a complete or partial solution, and as to whether self-regulatory or prescribed codes were to be preferred.

149 See, for example, Productivity Commission, *Review of Australia's Consumer Policy Framework*, Chapter 5.

150 Consider the *Dukemaster* and *World Best Holdings* decisions.



The panel notes that retail tenancy is regulated by the States and Territories rather than the Commonwealth, and while the unconscionable conduct provisions of the TPA may be available to retail tenants they are not their sole source of redress. Further, the retail tenancy industry has been through national review recently, in the context of the Productivity Commission's 2008 inquiry report on *The Market for Retail Tenancy Leases in Australia*. In addition, there has also been at least one state-based review of retail tenancy that touches upon aspects of unconscionable conduct.<sup>151</sup> The panel notes that the PC recommended the introduction a voluntary industry code of conduct.<sup>152</sup>

### The changing landscape

Finally, the panel notes the extensive changes that this area of the law is currently undergoing, as well as the effect that the panel's recommended changes might have if introduced. The history of the fair trading debate in Australia shows a continual motion back and forth concerning a variety of policy ideas. In franchising, for example, there were four inquiries in the course of just over two years between the Matthews and Joint Committees' reports.

The unconscionable conduct aspects of the panel's work are also the result of a recent inquiry, which followed a series of previous inquiries examining similar issues. The panel has been asked to look at both unconscionable conduct and conduct in franchising, which are closely and historically related issues, but it is important to note the various industries in which similar issues exist and to be mindful of the ripple effect that changes here could have elsewhere.

As detailed in this report, the panel recommends clarifying the law to recognise its development, which is best articulated by the decisions of the Full Federal Court in *ASIC v National Exchange Ltd* and the NSW Court of Appeal in *Attorney General of NSW v World Best Holdings Ltd*. This is a 'light touch' measure, intended to bolster judicial interpretation and application of statutory unconscionability, without undue interference with the established structure and present trajectory of the law in this area.

In summary, the panel considers that an interpretative statement of principles, improved uniform national guidance on statutory unconscionable conduct, the bringing of further test cases, and harmonised consumer and business provisions, would be meaningful and targeted reforms, which would appropriately be adopted at this time in conjunction with the introduction of the ACL.

However, once the ACL has been introduced and the other changes made, this should be an opportunity for stakeholders, including governments, to take a 'deep breath' and examine the emergence of the new trade practices landscape. If there are arguments to be made for further reforms, they will be best made on the basis of evidence, which can only be gathered

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151 See, for example, NSW Department of State and Regional Development, 'Issues affecting the retail leasing industry in New South Wales', Discussion Paper, April 2008, available at [www.retail.nsw.gov.au](http://www.retail.nsw.gov.au).

152 Productivity Commission, *The Market for Retail Tenancy Leases in Australia* (2008), page 257 (Recommendation 5).

over time while the changes in the laws take effect. To this end, in Chapter 4 the panel discusses the importance of further research initiatives in this area.

A period of three to five years would provide sufficient time to evaluate evidence of the effectiveness of changes to the provisions. A shorter span of time may not allow the law to develop sufficiently, particularly if further test cases are to be brought under the amended provisions. Future evaluation of the effectiveness of the provisions would be assisted by more research, particularly focused on empirical research. Whatever the mechanism, it is important that future considered debate concerning statutory unconscionable conduct take place with the assistance of extensive empirical and analytical research.

## Findings

- 2.1 In many circumstances, statutory unconscionable conduct can be difficult for stakeholders to understand and for the courts to apply, which contributes to a lack of certainty and confidence surrounding the effect of the provisions.
- 2.2 A list of examples will not improve understanding or implementation of the provisions.
- 2.3 Interpretative principles, as an aid to interpretation of the provisions, would assist the courts in interpreting the provisions, stakeholders in understanding them and regulators in enforcing them.
- 2.4 The principles should recognise that section 51AC (and, arguably, section 51AB) of the TPA and equivalent provisions of the ASIC Act are intended to go beyond the scope of the equitable and common law doctrines of unconscionability, and are not confined by them.
- 2.5 The following principles may also be distilled from relevant case law and the policy intention of previous and current governments:
  - the court may consider the terms and progress of a contract;
  - the provisions may apply to systems of conduct or patterns of behaviour; and
  - the identification of a special disadvantage is not necessary to attract the application of the provisions.
- 2.6 Given there will be a single national law with respect to statutory unconscionable conduct under the Australian Consumer Law, with penalties and increased enforcement powers for regulators, it is timely for the ACCC, ASIC and state and territory regulators to develop uniform national guidance on the provisions, along similar lines to the guidance being prepared for the new unfair terms regime.



## Findings (continued)

- 2.7 Regulators should pursue further test cases to inform their guidance material, over time. These test cases should draw on conduct in diverse industries, and should also be used to assist in the understanding of any interpretative principles introduced for the provisions.
- 2.8 As part of the process for introducing statutory unconscionable conduct into the Australian Consumer Law, the Government should consider harmonising or unifying sections 51AB and 51AC.
- 2.9 The efficacy of the changes to statutory unconscionable conduct currently being introduced, and of any changes introduced as a result of this report, should be assessed after three to five years. This assessment will be assisted by improved mechanisms for empirical and other research, as discussed in Chapter 4.



## 3 FIVE FRANCHISING BEHAVIOURS

### FRANCHISING BEHAVIOURS

On 5 November 2009, the Government responded to the Joint Committee's report on the operation of the Franchising Code.<sup>153</sup> The Joint Committee inquired into the operation of the Code with a view to identifying justifiable improvements. The Government response to the report agreed to nine recommendations (some in full, some in part, some in-principle) of the 11 recommendations put forward. However, as part of the Joint Committee consultation process and consultations undertaken in preparing the Government response, several specific behavioural issues (noted below) were brought to the Government's attention. This panel was convened to consider whether further amendments to the Franchising Code are required to address these behaviours.

The panel acknowledges the Government response<sup>154</sup> on the good faith recommendation, in particular, the Government's concerns that a general obligation to act in good faith carries risks for the regulatory environment, given the lack of judicial certainty and consensus as to the meaning and scope of the concept of good faith. This issue is discussed in Chapter 4.

### Considerations and challenges

The Joint Committee noted that 'the diverse nature of the franchising sector presents the potential problem that a specific change, while beneficial for one system, may have unintended consequences for another'<sup>155</sup>, and that these behaviours cannot be considered in isolation. The different contexts and manners in which they occur are important in determining whether the behaviours are inappropriate in a franchising arrangement. For example, different circumstances may render these behaviours as sensible business practice on the part of the franchisor or, in other contexts, inappropriate or unreasonable.<sup>156</sup>

In considering the appropriateness of these behaviours, a key challenge for the panel has been to ensure that any proposed changes to the Franchising Code to prevent any inappropriate behaviour will not have a detrimental impact on the franchising sector as a whole. The panel has also considered the franchising relationship. The Joint Committee noted that there 'is an inherent and necessary imbalance of power in franchise agreements in favour of the franchisor'.<sup>157</sup> This imbalance in power remains a concern for many franchisees,

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153 Commonwealth Government Response to the report of the Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, 2009 (hereafter 'Government response to the Joint Committee report').

154 *ibid.*, pages 13-4.

155 Parliamentary Joint Committee on Corporations and Financial Services, *Opportunity not opportunism: improving conduct in Australian franchising*, 2008, page 114 (hereafter 'Joint Committee report').

156 For example see the discussion below concerning unilateral contract variation.

157 Joint Committee report, page 101.

and it is important to consider this power imbalance in the context of the five franchising behaviours. The imbalance may introduce problems into the franchising sector beyond those of standard market forces. For example, one submission to the Joint Committee suggested that agreements can change over time without the ability for the franchisee to negotiate the changes.<sup>158</sup> Another important consideration has been the potential impact on franchise systems. While the behaviour of some franchisors may be detrimental to some franchisees within a system, the behaviour may be to the benefit of the system as a whole, or the franchise brand.

The panel is also conscious of the fact that, through the Franchising Code, the Government has sought to achieve a balance between protecting franchisees from unfair practices and protecting the freedom of both franchisors and franchisees to conduct business in a competitive manner. The panel is mindful that franchising is not the only industry with this regulatory approach (noting the similar approach in the Oilcode), and that other industries may share similar business practices to those discussed in this chapter.

The Franchising Code was the first industry code mandated under the TPA. Accordingly, the panel has been mindful that the Franchising Code may be held up as an example or precedent for other codes of conduct. For example, the Oilcode Review noted that the suggested changes to the disclosure requirements in the Oilcode Review are consistent with the 1 March 2008 changes to the Franchising Code<sup>159</sup> and that many of the recommendations on dispute resolution aim to ensure that the Oilcode is consistent with similar arrangements under the Franchising Code.<sup>160</sup> The panel is aware, therefore, of the influence any changes to the regulation of franchising may have on regulation and business practices in other industries.

The Franchising Code, like other codes of conduct, is drafted to address specific problems. The panel recognises the importance of the Franchising Code providing practical solutions to the problems identified in the sector, as well as the need to avoid inserting vague concepts or aims and ideals into the Franchising Code.

### **Link between behaviours**

In analysing the behaviours, the panel has observed a link in particular between three of the five behaviours:

- unilateral contract variation;
- unforeseen capital expenditure; and
- franchisor-initiated changes to franchise agreements when a franchisee is trying to sell the business.

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158 Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, Friday 17 October 2008, page CFS25 (Mr Robert Gardini, Solicitor, MTAA).

159 Department of Resources, Energy and Tourism Oilcode Review: *Statutory review of the Trade Practices (Industry Codes – Oilcode) Regulations 2006*, May 2009, page 7.

160 *ibid.*, page 9.

All three of these behaviours have the potential to influence the franchisee's return on investment and the decisions of prospective franchisees about whether to enter the franchise. Any of these behaviours could arise in tandem with the others. For example, a unilateral contract variation requiring capital expenditure in the period approaching the franchisee's sale of the business may vitiate the franchisee's capacity to recoup that outlay, even with the financial return from the sale. Moreover, the value of that sale may have changed (either positively or negatively) as a result of the variation or expenditure, which affects the interests of both incoming and outgoing franchisees. Each of these behaviours carries this risk and uncertainty, which makes it difficult for franchisees to assess, at the point at which they make their decision to enter an agreement, their prospects of recovering their investment in the franchise.

During the Joint Committee inquiry it was noted that there is only limited data available on the Australian franchising sector. The Government response also acknowledged the difficulties of assessing the efficacy of the Code's provisions in the absence of reliable and insightful data on the extent of disputation in the sector.<sup>161</sup> Accordingly, it is difficult to assess the prevalence and context of the five behaviours. While there is anecdotal evidence to suggest that these behaviours may be inappropriate in some circumstance in a franchising context, it is unclear whether they represent systemic problems within the sector.

Information used to inform this analysis has been obtained from submissions to the Joint Committee, the state inquiries, as well as discussions with ACCC officers and the ACCC Franchising Consultative Committee. The panel's consideration of the five behaviours has also included an examination of regulatory responses in overseas jurisdictions; however, such analysis has provided limited insight into the issues currently before the panel.

### Regulatory options

The options for addressing each of the five behaviours fall along a spectrum of regulatory alternatives. Options include more direct disclosure requirements and improved educative measures, allowing certain events to 'trigger' consultation requirements or other rights, and conditional or absolute prohibition of certain conduct. In each case, where appropriate, these options have been considered with a view to recommending a proportional response to problems associated with each issue. However, given the interrelatedness of the five behaviours, their analyses should not be read in isolation, and the recommendations should be viewed as a holistic package of measures to address the aggregated effect of the behaviours.

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161 Government response to the Joint Committee report, page 19.

## I UNILATERAL CONTRACT VARIATION

### Key points

- Franchisors may have legitimate reasons to unilaterally vary terms in agreements to respond to market and regulatory demands.
- Unilateral contract variations occur on a spectrum between variations that are acceptable to all parties and those that may cause detriment to one party.
- Greater disclosure and education may be required before parties enter into an agreement, to ensure that both parties appreciate the existence and implications of clauses enabling unilateral contract variations. This disclosure (and education) needs to be provided in a meaningful manner, and at a time in the decision process that enables prospective franchisees to undertake their due diligence.

### Identifying the problem

The Joint Committee received submissions expressing concerns that the Franchising Code does not prohibit the unilateral variation of franchise agreements. The Joint Committee noted similar concerns relating to the inclusion of clauses in franchise agreements that stipulate that a franchisee will comply with an operations manual supplied by the franchisor, the contents of which are subject to change at any time.<sup>162</sup>

The Government's response to the Franchising Inquiry recognised that in the interests of business efficacy, franchisors may need to make commercial decisions to maintain and revitalise their franchise model.<sup>163</sup> However, while recognising the commercial nature of franchising, the Government's response also acknowledged that unilateral changes to a franchise agreement may affect the viability of the franchise for individual franchisees.

In its evidence before the Joint Committee, IndCorp Franchisees Association of Australia noted that while it:

accepts and recognises the importance of a strong brand and the need for the franchisor to have the power to establish the strong guidelines and the criteria by which prospective and existing franchisees can operate a store ... [the] issue is when a franchisor reserves the right to change it at any time and with very little negotiating or communication with the franchisees.<sup>164</sup>

Unilateral contract variation is a complex matter involving competing perspectives. The Joint Committee noted that, for franchisees, the appeal of a franchise is the potential benefit of being able to operate a business while relying on an existing brand name and prescribed

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162 See pages 53-6 of the Joint Committee report.

163 Government response to the Joint Committee report, pages 17-18.

164 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Brisbane, Friday 10 October 2008, page CFS74 (Ms Zali Steggall, Barrister, IndCorp Franchisees Association of Australasia).

operating system.<sup>165</sup> Such a system is determined by and carried out under the guidance and oversight of the franchisor. Accordingly, there may be valid reasons for franchisors to introduce unilateral changes; for example, in order to protect or revitalise their brand or ensure consistency across the franchise system.

Conversely, unilateral variation imposes obligations (and, relevantly, costs) on a franchisee that may not have been in contemplation when the franchise agreement was signed.

The panel considers that there are four main circumstances in which unilateral contract variation may arise as an issue:

- some franchisees enter into franchising agreements without fully appreciating that their franchisor has the right to unilaterally vary the agreement (disclosure);
- a franchise agreement may mandate that the franchisee must comply with an operating manual (or equivalent), which can be unilaterally varied at any time (business operations);<sup>166</sup>
- unilateral variations could potentially affect the viability of individual franchise units – for example by introducing unforeseen costs (unforeseen capital expenditure);<sup>167</sup> and
- franchisors may initiate changes to franchise agreements when a franchisee is trying to sell a business (franchisor-initiated changes during sale).

The first two items, which raise related issues regarding disclosure and business operations, will be discussed below. The remaining items are franchising behaviours specifically referred to the panel, and will be discussed in subsequent sections.

#### Disclosure and business operations

A franchise agreement may confer on the franchisor the right to unilaterally vary the franchise agreement, or to vary documents applying to the franchise system (and incorporated by reference in the agreement). For example, a franchise agreement may permit the franchisor to vary an operations manual, with a corresponding obligation on the franchisee to comply with that variation.

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<sup>165</sup> Joint Committee report, page 5.

<sup>166</sup> See a discussion between Mr Bernie Ripoll MP and Mr Tony Piccolo MP regarding operations manuals and the fact that they can be changed at any time and that these franchise agreements are often subject to these operations manuals: Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, Wednesday 5 November 2008, page CFS56.

<sup>167</sup> Mr Michael Delaney, Executive Director, Motor Traders Association of Australia noted that the purpose of disclosure is to provide franchisees with sufficient information to decide whether or not to enter into the business agreement and that it is on the basis of that disclosure that the potential franchisee assesses the financial rewards and risks associated with the business. Unilateral changes to the terms of the agreement may result in revised agreement terms that are materially different to those contained in the original agreements and that in such circumstances, the franchisee may not have entered into the agreement had the revised terms been included in the original agreement. See Submission (number 90) from the MTAA to the Joint Committee, page 14. Public submissions to the Joint Committee are available from the Parliamentary website, [www.aph.gov.au](http://www.aph.gov.au).

The disclosure requirements under the Franchising Code include requirements to disclose references to variation and operations manuals. For example, item 16.1(f) requires franchisors to disclose references to the relevant conditions of the franchise agreement that deal with a franchisee's obligations with respect to complying with standards or operating manuals. Items 17.1(b) and 17.1(r) in Annexure 1 of the Franchising Code require franchisors to disclose references to the relevant conditions of the franchise agreement that deal with variation and operations manuals respectively.

### Stakeholder perspectives

While franchisors need to ensure the commercial viability of their franchise, some franchisees consider that unilateral contract variation could represent a form of inappropriate conduct. For example, unilateral variations could be used to change the fees payable by the franchisee under the agreement<sup>168</sup> or the contract terms dealing with minimum performance.<sup>169</sup> As the MTAA observed:

The ability of the franchisor to subsequently vary the terms of the agreement in a unilateral manner may, therefore, result in a circumstance whereby the revised terms of the agreement are materially different to those contained in the original agreements. In such circumstances, it is possible that the franchisee may not have entered into the agreement had the revised terms been included in the original agreement.<sup>170</sup>

The MTAA further noted that the purpose of disclosure is to provide franchisees with sufficient information to decide whether or not to enter into the business arrangement proposed by the franchisor.<sup>171</sup> To this extent, the franchisor's disclosure document is a tool which assists franchisees to undertake their due diligence and make informed decisions about whether to enter into a franchise agreement. It is arguable that the information provided in the disclosure document should be sufficient to enable franchisees to decide whether or not to enter into the business agreement proposed by the franchisor. Adequate disclosure should also make it clear to the prospective franchisee that changes to the agreement could render the terms of the arrangement materially different to those originally considered by the franchisee.

Conversely, some franchisors point to the flexibility required to respond to changes in an industry, and to changing market conditions.

The Federal Chamber of Automotive Industries' (FCAI) submission to the Joint Committee noted that as 'a relational contract, it is clear that various commercial elements of a franchise agreement will need to be modified from time to time in order to reflect the dynamic nature of a franchise business system.'<sup>172</sup> Given that modifications may be necessary as part of the business relationship between the franchisor and the franchisee, there may be concerns about the extent to which the concept of unilateral variation would include changes in programs,

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168 Submission (number 51) from the Franchisees Association of Australia to the Joint Committee, page 21.

169 Submission (number 39) from Dr Elizabeth Spencer to the Joint Committee, page 4.

170 Submission (number 90) from the Motor Traders Association of Australia to the Joint Committee, page 14.

171 *ibid.*

172 Submission (number 155) from the FCAI to the Joint Committee, page 23.



strategies, presentation, policies, models and brands and other elements essential to the efficient operation of a franchise system.

The FCAI also noted that a material variation to the detriment of the franchisee would be covered by provisions such as section 52 of the TPA as well as the general principles of estoppel. Section 51AC of the TPA expressly provides (in the context of unconscionable conduct) that one of the relevant matters to which a Court is to have regard, is whether the 'supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer for the supply of the goods and services.'<sup>173</sup>

Yum! Restaurants Australia (YRA) commented that franchisors make decisions not only in their own interest but also in the interest of the franchise system as a whole. In its submission to the Joint Committee, YRA noted that:

[i]n a business setting, things can and do happen which may seem 'unfair' from one person's perspective but which clearly are not fraudulent, abhorrent or beyond all good conscience. Any attempt to prevent businesses from exercising their business judgment within these bounds would be inappropriate and could seriously impact the development of the industry in question.<sup>174</sup>

Yum! Restaurants International also noted:

that franchise systems are only as strong as their brand. Franchisors such as Yum! spend vast sums of money investing in their trade mark, system and image. The franchisor is responsible to all of its franchisees to take steps to preserve and enhance the brand.<sup>175</sup>

Where variation clauses are drafted so that variation rights may only be exercised when triggered in circumstances agreed by both parties (for example, a change in the law), this can provide flexibility in a franchising agreement. However, variation clauses that are not referable to any external trigger or subject to further negotiation between parties may be of concern.

Further, contract terms conferring unfettered discretion to vary the agreement on one party (invariably the party with relatively greater bargaining power) may constitute a condition that is not reasonably necessary for the protection of the legitimate interests of that party. While courts may have regard to such conditions when considering allegations of unconscionable conduct within the meaning of section 51AC of the TPA, the imposition of such a term is not unconscionable *per se* within the meaning of that provision.

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173 Submission (number 155) from the FCAI to the Joint Committee, page 23.

174 Submission (number 118) from Yum Restaurants Australia to the Joint Committee, pages 14-5.

175 Yum! Restaurants International submission to the South Australian Parliamentary Economic and Finance Committee, page 3. Public submissions to this inquiry are available on the SA Parliamentary website, [www.parliament.sa.gov.au](http://www.parliament.sa.gov.au).

## **The panel's view**

The panel agrees with stakeholders' comments that franchising agreements need to reflect the dynamic nature of franchising and like all business relationships they may need to change from time to time. Franchisors need to be able to make changes to their systems to: ensure that the franchise business remains current and relevant to the market place; reflect changes in consumer demand; and reflect changes in technology. The panel considers an outright prohibition of clauses in franchising agreements that allow franchisors to unilaterally vary the franchise agreement or their operating manuals may have serious implications on the viability of franchising as a business model.

The panel's discussions with franchisors and franchisees indicated that the problem of unilateral contract variation is experienced differently in different industries. While the panel has not been presented with sufficient evidence to determine conclusively the extent of the problem, it has enough information before it to recommend specific measures in this area.

Unilateral changes to a franchise arrangement may be a necessary component of the franchise system. The panel considers there are legitimate business reasons for such variations to occur. Consequently, without strong evidence of overwhelming detriment occasioned by unilateral contract variations, it is not desirable to consider an absolute prohibition.

Concerns about variation relate primarily to requiring franchisees to undertake significant capital expenditure. Unforeseen capital expenditure is discussed in greater detail later in this chapter. It is difficult to analyse the extent of any problems associated with variations to the operations manual, given the spectrum of opinion as to what elements of a manual may acceptably be varied unilaterally.

### **Spectrum of unilateral variations**

The panel notes that stakeholders have listed a wide variety of items and circumstances in which franchisors unilaterally vary their contracts with franchisees. There appears to be some level of consensus amongst franchisees and franchisors over changes to the franchise system that benefits the system as a whole, for example changes to occupational health and safety policy or changes to products that make the overall franchise business more profitable for all franchise participants. The panel considers that unilateral changes welcomed by both parties should not be subject to the additional compliance burden that may result if an absolute prohibition were to be implemented.

Therefore, the panel considers that unilateral contract variations occur on a spectrum. On one extreme, the franchisee and franchisor may be in agreement about unilateral changes to the agreement. At the other, unilateral variation of a contract can represent inappropriate conduct.

The panel notes that in circumstances where unilateral variation represents inappropriate conduct, it is possible that current legislation may offer some recourse to franchisees. There are remedies in the TPA to cover situations where a unilateral change introduced by a franchisor is seriously detrimental to a franchisee, including the provisions applying to unconscionable conduct. Unilateral variation is a factor specifically listed in section 51AC of

the TPA as one to which the court may have regard. If there is a right to unilateral variation, and conduct associated with this right is unconscionable in all the circumstances, the conduct is prohibited by the TPA. Given the additional enforcement powers that will be introduced for unconscionable conduct, the consequences for franchisors varying their agreements unconscionably will be amplified. They may, indeed, be subject to civil penalties of up to \$1.1 million.

Where a unilateral contract variation does not fall into this inappropriate category, franchising parties on all sides may reasonably hold different views about what is reasonable behaviour under the franchise agreement. Consequently, franchisees and franchisors will not always agree what would be an acceptable reason for the franchisor to vary the contract unilaterally. Moreover, the panel considers it would be difficult to categorise in the abstract what is or what is not an acceptable reason for unilateral variation.

#### **A conditional right to unilateral contract variation**

It is for this reason that the panel is inclined not to support suggestions that the Franchising Code permit unilateral variations only contingent upon some external event, or that it require compensation be paid where a variation causes certain costs to be incurred.

Both these kinds of measures involve some degree of contingency, and that contingency would be difficult to define. If defined too broadly (such as, 'any change to the Franchising Code entitles the franchisor to vary the agreement'), the threshold event could trigger widespread contract variations with little relationship to the event upon which variation is contingent. If too narrow, the provisions would likely have little utility, as their application would be rare. In the middle would be uncertain threshold events, such as when a change 'unreasonably' affects the interests of the franchisee. Such a provision would not add to business certainty about the effect of the Franchising Code.

Making the acceptability of a variation contingent upon an evaluation of whether some threshold has been met or exceeded runs the risk of deflecting the attention of franchising parties to a collateral dispute about the threshold itself, increasing transaction costs and the likelihood of disputes arising. If a dispute arises about a unilateral variation, the disputing parties would do better to focus on the variation itself, rather than on whether some threshold event had taken place to allow the variation.

Similarly, it would be difficult to define in the Franchising Code any circumstances in which a right to compensation might be appropriate. Certainly, a variation to the operations manual may require franchisees to bear certain compliance costs. However, the franchisor will likely have borne costs in developing, evaluating and introducing the changes to the operations manual. The changes are likely to be such as to enable the franchise business – as a whole – to continue to compete in a changing market place and to increase the profitability of the business.

It is unclear, then, what losses remain to be compensated for, when the alternative may be the failure of the business model. There is a risk that variations to an operations manual may simply allocate the risk of a business change to the franchisee that pays for it, rather than the

franchisor that makes the decision. But there is no obvious mechanism for determining whether or not that allocation is inefficient and deserves compensation.

While the panel acknowledges that franchisors will not always be able to predict when unilateral changes to an agreement are necessary (for example, to meet changes in regulations or market demand), it is important to ensure that prospective franchisees have access to all of the information that they need in order to undertake their due diligence. This information needs to be provided early in the decision-making process, and should include information on unilateral contract variations. Such information, provided early and in a meaningful manner, will assist prospective franchisees assess the proposed business venture.

### **Education and disclosure**

Given that no agreement on the acceptability of a variation is likely as between stakeholders with different perspectives, and that an objective threshold of acceptability is difficult to determine, the panel considers that this behaviour may be dealt with appropriately through better disclosure up front, together with better education for the sector, which may make prospective franchisees more aware of the possibility of unilateral variation of their franchise agreements.

Better disclosure could involve disclosing the circumstances in which unilateral variation may take place, including whether it may involve capital expenditure by the parties. For example, the franchisor could disclose, in a generic way, the circumstances in which it has unilaterally varied a franchise agreement in the past three financial years.<sup>176</sup>

The panel recognises that increasing the disclosure requirements of the Franchising Code risks lengthening what may already be a large disclosure document. This may impose record-keeping requirements on franchisors as well as imposing an additional burden on franchisees in comprehending and seeking advice on an increased amount of information. However, if the disclosure requirements could be appropriately targeted to avoid unduly burdensome outcomes, the panel considers that this would be useful information to assist franchisees and prospective franchisees in evaluating up front the risks attending their franchise agreements, so they can make arrangements for their financial stability.

The panel considers some of these concerns about large disclosure documents could be mitigated by the development of a short, simpler plain English disclosure document, to be provided in addition to (and not instead of) the existing disclosure documents. This short disclosure document would be a ready reference to the nature of the franchise relationship, highlighting items the prospective franchisee needs to consider, including unilateral contract variation through the operations manual. This short disclosure document is discussed later in the chapter under enhanced disclosure, further measures.

Education is also an important element in encouraging prospective franchisees to consider, evaluate and prepare for the risks associated with unilateral contract variation. Particularly if the nature of any likely unilateral variation is disclosed by franchisors, there is a role for both

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176 Three financial years is the period within which the Franchising Code already requires franchisors to disclose certain past information. See item 6.4 of Annexure 1.

regulators and the sector in highlighting this disclosure and the importance of considering the attendant risks. Guidance material about the existence and nature of the practice of unilateral variation would assist prospective franchisees in carrying out their due diligence, and better arm franchisees with an understanding of their rights and responsibilities.

While the panel has enough information before it to recommend increased disclosure, it considers its analysis of this behaviour would have benefited from greater information being available concerning the incidence of unilateral variation and the consequences for both franchisors and franchisees. In Chapter 4, the panel considers the appropriateness of a comprehensive framework for research and advocacy in the context of small business issues. The use of unilateral variation clauses should be included in any enhanced research agenda.

## II UNFORESEEN CAPITAL EXPENDITURE

### Key points

- Franchisees may be required, at times, to undertake capital expenditure to remain competitive and responsive to market demands, franchise improvements and regulatory changes. However, there may be situations in which a franchisee has insufficient opportunity to recoup this investment.
- Greater disclosure may be required to ensure that prospective franchisees, before committing to the franchise, gain access to essential and meaningful information without unduly burdening both franchisees and franchisors. This information should enable the franchisee to appreciate what will happen at the end of the term.

### Identifying the problem

During franchising consultations, concerns were raised that the term of a franchise agreement may not be long enough for franchisees to recoup their capital expenditure. For example, requirements for franchisees to purchase new equipment or undertake store refurbishments in the months before their agreement ends could result in significant financial hardship for the franchisee if the agreement is not renewed.

The Government response to the Joint Committee inquiry recognised that the negotiation of and agreement to the terms of a franchise agreement is a commercial matter.<sup>177</sup> The response noted that parties to an agreement must ensure that the term of the agreement is sufficient to recoup expenditure, while also recognising the potential financial implications of capital outlay on franchisees. The term of the agreement and the capacity to recoup expenditure is also of relevance to the capacity of the franchisee to secure financing for any capital expenditure.

The panel considers that there are two main circumstances in which unforeseen capital expenditure may arise as an issue:

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177 Government response to the Joint Committee report, page 17.

- Franchisees may be required to commit to capital outlay that was not outlined to the franchisee prior to entering into the agreement (unforeseen costs).

– In a submission to the Joint Committee, Ms Deanne de Leeuw noted:

I have been told of instances where franchisees are directed to undertake expensive refurbishments or their agreement will not be renewed. Sometimes after the refurbishment is completed, the franchisor still refuses to renew the agreement and gains a newly refurbished store that they can either keep or re-sell. The franchisee is left with nothing except debt.<sup>178</sup>

- The term of franchise agreement may be too short for franchisees to recoup their capital expenditure, or the expenditure may be required too near the end of the term of the agreement to recover the investment in the franchisee's view (return on investment).<sup>179</sup>

### Unforeseen costs

Under item 13.6 of Annexure 1 of the Franchising Code, a franchisor must disclose details of each recurring or isolated payment payable by the franchisee to the franchisor or an associate of the franchisor or to be collected by the franchisor or an associate of the franchisor for another person. These details include:

- (a) description of the payment;
- (b) amount of the payment or formula used to work out the payment;
- (c) to whom the payment is made;
- (d) when the payment is due; and
- (e) whether the payment is refundable and, if so, under what conditions.

Item 13.7 of Annexure 1 provides that if the amount of the payment (under item 13.6) cannot easily be worked out, the upper and lower limits of the amount must be provided.

Given that the Franchising Code requires franchisors to disclose details of mandatory payments, it is important to consider the circumstances in which expenditure may be unforeseen. This area can be complex in that it is hard to determine what is and what is not unforeseen.

Unforeseen capital expenditure could arise for a number of reasons, as follows, each of which is discussed below:

- inadequacies in the Franchising Code's disclosure requirements;

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<sup>178</sup> Submission (number 114) from Ms Deanne de Leeuw to the Joint Committee, page 29.

<sup>179</sup> For example, Mr Wayne Spencer, Executive Director, Retail Traders' Association of Western Australia, identified the practice of unreasonably shortening the term of franchise agreements which gives insufficient time for the franchisee to fully depreciate his capital investment. Submission (number 14) from Retail Traders' Association of Western Australia to the Joint Committee, page 2.



- unilateral contract variations; and
- other arrangements (for example, requirements imposed by a landlord).

#### Inadequacies in the Franchising Code's disclosure requirements

Some instances of unforeseen capital expenditure, in the form of payments to the franchisor, may be linked to a franchise's operations or procedural manual.<sup>180</sup> It is unclear whether or not these manuals are provided to prospective franchisees before the franchise agreement is signed. Where a prospective franchisee has access to an operations manual before entering into an agreement, this may provide an indication about the possibility of future capital expenditure.

Clause 22.3 of the Franchising Code provides that the franchisor can also provide any other information that it considers relevant, and which does not contradict information required to be given. However, there is no requirement in the Franchising Code for the franchisor to provide a copy of the standards or operating manual as part of the disclosure process prior to the signing of the agreement.

Neither is there a requirement to disclose expenditure that is required by other parties. Where the franchisee is required to engage in expenditure of this kind in fulfilment of its obligations under the franchise agreement, notwithstanding that the franchisor has no direct benefit from the expenditure, there may be ambiguity about the nature and extent of the expenditure. The ACCC has alerted the panel to the concern that item 13.6 of the disclosure document covers only payments payable to the franchisor or collected by the franchisor, and not payments required by a franchisor but not collected by the franchisor. In the panel's view, this 'loophole' should be closed. Where expenditure of this kind is within the knowledge or control of the franchisor, or is reasonably foreseeable by the franchisor, it may be appropriate to require it to be disclosed.

#### Unilateral contract variations that lead to unforeseen capital expenditure

Another reason for exposure to unforeseen expenditure could be due to unilateral contract variations. Under this scenario, franchisees could be exposed to additional capital outlays.

There could be valid reasons for unilateral variations resulting in unforeseen capital expenditure. For example, a franchisor could disclose to a franchisee all details of recurring or isolated payments that were required under the agreement at a set point in time. However, due to changing circumstances (that is, results of market research/market pressures) the franchisor may introduce unilateral contract variations to affect the rebranding of the franchise. This could require a shop re-fit or changes to standards or the introduction of new policies requiring new equipment.

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180 Mr Judkins, CEO, Lottery Agents Association of Victoria, noted that a 'change to [the operating manual], say in relation to the shopfit requirements can be in effect a major change to the franchise agreement and a major cost'. Submission (number 45) from Lottery Agents Association of Victoria to the Joint Committee, page 3.

The introduction of unforeseen refurbishments or other costs may introduce significant financial difficulties for franchisees, particularly if costs are introduced close to the end of the franchise term. However, in the case of rebranding, a franchisor needs to consider all of its franchisees as well as the image of the franchise as a whole. As such, the franchisor may need to ensure refurbishments were introduced into all of its franchised outlets within a defined timeframe. The panel understands that individual franchise agreements are likely to have different start and finish dates, therefore some franchisees could face unforeseen refurbishment costs at the end of their term, others could face these costs at the beginning of the term and others could face the costs in the middle of the term. It is also important to consider that while shop re-fits or the introduction of new policies may require substantial capital outlays from franchisees, a refurbished shop may attract additional customers, which could be beneficial to both individual franchisees and the franchise as a whole.

### Other arrangements

Some franchisors may require re-fits to be undertaken as a requirement for renewal. However, these re-fits may not guarantee renewal of the franchise agreement.<sup>181</sup> It is not always clear if such re-fits were outlined in the original franchise agreement, if the threat of non-renewal is simply a means for the franchisor to obtain a newly re-fitted shop that can be on sold to a new prospective franchisee, or if there are other circumstances driving the re-fit.

During the Joint Committee's public hearings, the Shopping Centre Council of Australia noted that:

a lessor cannot require a fit-out during the term of the lease unless it is specifically negotiated in the lease itself. Usually what happens is in relation to a renewal of a lease one of the conditions of renewal may be the requirement of a new fit-out ... refreshment of a restaurant or refreshment of a retail shop is very important in terms of continuing to attract custom. That is why, on a renewal, part of the terms of the renewal may in fact be the requirement to have a new fit-out.<sup>182</sup>

A franchisor may have a greater capacity to negotiate competitive leasing arrangements for its franchisees than individual franchisees. In circumstances where a franchisee's leasing arrangements fall under a head lease held by the franchisor, it is possible that the lease term may not match the franchise term. In these circumstances, as noted above, a lessor may make a new fit-out a condition of a lease. This situation could place a franchisor in a difficult situation whereby the franchisor can direct its franchisees to undertake a fit-out to secure the new lease, or not renew the lease, in which case the franchisee's agreement might be terminated.

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181 Ms Deanne de Leeuw indicated that some 'franchisees are directed to undertake expensive refurbishments or their agreement will not be renewed'. However, Ms de Leeuw indicated that sometimes, 'after the refurbishment is completed, the franchisor still refuses to renew the agreement'. Submission (number 114) from Ms Deanne de Leeuw to the Joint Committee, page 29.

182 Evidence to the Joint Committee on Corporations and Financial Services, Parliament of Australia, Sydney, Thursday 9 October 2008, page CFS46 (Mr Milton Cockburn, Executive Director, Shopping Centre Council of Australia).



Under subclauses 14(1) and 14(2) of the Franchising Code, if a franchisee leases premises from the franchisor or an associate of the franchisor for the purposes of a franchised business, the franchisor or the associate from which the premises are leased must give to the franchisee either a copy of the agreement to lease or a copy of the lease within one month after the lease or agreement to lease is signed by the parties. If renewal of the lease requires a new fit-out, then the franchisee may be unaware of the costs associated with the fit-out until the lease has been signed. However, as suggested by the Shopping Centre Council's comments to the Joint Committee, the lease may not be renewed until parties agree to a new fit-out.

Retail leasing is a significant issue for franchisees, as it is for many non-franchisee small businesses. In 2008, the Productivity Commission (PC) released a report on *The Market for Retail Tenancy Leases in Australia*, in response to concerns about the conditions faced by small businesses in negotiating commercial leases. The PC made a number of recommendations, to which the Government has responded, and it is not for this report to cover the same ground in the specific context of franchising. However, it is important to note that the process for further policy developments following the PC review, as well as the changes the Government has announced relating to the Franchising Code (such as disclosure of end-of-term arrangements and advice about renewal) may address some of the problems in this area.

### Return on investment

During consultations, concerns were raised that the remaining term of the agreement may not be long enough for franchisees to recoup their capital expenditure.<sup>183</sup> Alternatively, capital expenditure may be required too near the end of the agreement to allow a return on investment. This could cause significant financial hardships for franchisees if the agreement is not renewed. Some industries (including the motor trades industry) can be particularly affected where large-scale capital outlays and investments cannot be recouped.

Franchising agreements do not expire at the same time and franchisors may require franchisees to undertake capital expenditure simultaneously (for example a requirement to update or refit their store). Problems may arise where franchisees are required to undertake capital expenditures when their agreements are nearing the end of the franchise term.

Many franchise agreements in the motor trades industry have moved from evergreen agreements to fixed term arrangements, which have increasingly been shortened over the years. During a Joint Committee hearing, the MTAA suggested that there are increasing problems with tenure, noting that people 'are entering into franchises on the supposition or promise of tenure sufficient to ground and found borrowings for the cost of the franchise agreement, only to find that, once they are in it, the tenure can be quite wilfully truncated or

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183 Mr Wayne Spencer, Executive Director, Retail Traders' Association of Western Australia, has suggested that 'another form of 'franchisor opportunism' exists with the apparent and continuing practice of unreasonably shortening the term of franchise agreements ... [which] gives insufficient time for the franchisee to fully depreciate his capital investment'. Submission (number 14) from Retail Traders' Association of Western Australia to the Joint Committee, page 2.

concluded'.<sup>184</sup> The MTAA also noted that 'there is usually not a fee for the franchise. There is instead a capital requirement to build the whole facility and to stock it. It is just extremely difficult if there is no right of renewal'.<sup>185</sup> This may result in agreements being too short for the franchisee to recoup the capital required to enter into these agreements.<sup>186</sup>

Most franchisees require an agreement to be renewed to make a large capital outlay viable. In some industries, particularly the motor retail trade sector, franchisees may be required to undertake large capital expenses (for example a new showroom). Where these refurbishments are undertaken towards the end of their franchise agreement, there may not be sufficient time to recoup these outlays before the expiration of their agreement.

Because of the significant investment made by franchisees throughout the duration of the franchise term, franchisees often feel they do not have the same bargaining power when negotiating the renewal of a franchise agreement. In his submission to the Joint Committee, Mr Robert Gardini noted that the 'one-sided nature of dealer agreements means that without the capacity and bargaining power, dealers willingly enter agreements which contain oppressive contractual clauses'.<sup>187</sup> Mr Gardini's submission suggests that the potential dealers do not have the ability to undertake negotiations to 'remove unfavourable and disadvantageous clauses'.<sup>188</sup> Mr Gardini elaborated on this view during a public hearing in Canberra, noting that:

[w]hen you make the original investment, that is really when you have the ability to do the due diligence and make a free choice. Once you have invested capital into that business over 20 or 30 years, the agreements get changed, but your ability to negotiate the change, either on an individual basis or through the dealer counsel's negotiating with the distributors, is just a total power imbalance. It is not freedom of contract. It does not reflect contractual negotiations that exist more generally in commerce because of the relationship that exists. It is a very different situation.<sup>189</sup>

## The panel's view

### Unforeseen costs

The panel considers there may be circumstances where the existence of unforeseen costs represents inappropriate conduct, and other circumstances where the behaviour represents sensible business practice. There is insufficient evidence available to the panel to arrive at conclusions about the prevalence of inappropriate conduct in this area. Moreover, there are legitimate reasons for which capital expenditure may arise. A general prohibition of the

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184 Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, Friday 17 October 2008, page CFS19 (Mr Michael Delaney, Executive Director, MTAA).

185 *ibid.*, page CFS24.

186 See a discussion between Mr Robert Gardini, Solicitor for the Motor Trades Association of Australia and Mr Delaney, Executive Director of Motor Trades Association of Australia, Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, Friday 17 October 2008, page CFS 25.

187 Submission (number 92) from Mr Robert Gardini to the Joint Committee, page 2.

188 *ibid.*

189 Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, Friday 17 October 2008, page CFS25 (Mr Robert Gardini, Solicitor, MTAA).

behaviour may constrain franchisors from making valid commercial decisions, and may not be a proportional response to a potentially confined problem.

The panel notes that requiring a franchisor to obtain the agreement of its franchisees prior to introducing unforeseen costs may be similar in effect to a general prohibition in circumstances where franchisees will not agree to any unforeseen costs. Similar to the concerns discussed previously in relation to unilateral contract variation, the difficulties in crafting a conditional prohibition of this kind of unforeseen expenditure, and the disproportionate response represented by an absolute prohibition, make such measures unattractive.

The panel notes that the ACCC's enhanced investigative powers, announced as a part of the Government's response, may assist where franchisees are exposed to unforeseen capital expenditure through inadequate disclosure. The unconscionable conduct provisions in the TPA may also provide recourse in some circumstances where franchisees have been exposed to unilateral contract variations resulting in unforeseen capital expenditure.

### **Return on investment**

The Joint Committee did not support an automatic right to renewal or the requirement for good cause to be shown for not renewing a franchise agreement. The Joint Committee was of the view that franchisors should be entitled to decline to renew franchise agreements on expiration if that is their choice.<sup>190</sup> It is a commercial decision for parties to a franchise agreement to agree to the terms of the agreement.

The panel notes that the new end-of-term arrangements, announced in the Government response, may assist prospective franchisees in assessing the commercial viability of the agreement they are considering. Under the changes, prospective franchisees should be given a clearer understanding of what will happen at the end of the term before they enter the agreement. This will be further assisted by the requirement for franchisors to advise franchisees whether or not the agreement will be renewed at least six months before the end of the term. A clear understanding of the parties' positions at the end of the franchise term will allow franchisees to analyse more comprehensively the consequences of any unforeseen capital expenditure, and to the extent that they are aware of the risk of such expenditure, this will also feed into their decisions about entering a franchise, bearing in mind their possible return on investment.

It may not be unreasonable for a franchisee in any industry to have developed an expectation of renewal, particularly where the franchise relationship is working well. Even where the renewal is not a legal right, it is certainly reasonable that a franchisee that engaged in unexpected capital expenditure, with the implicit understanding that a renewal could be expected, should be disappointed if the agreement is not renewed. The solution, then, beyond situations in which the doctrines of estoppel may apply, lies in arming franchisees with information to allow them to assess the viability before entering the franchise. Franchisees will then be able to appreciate their ability to recoup any expenditure and

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190 Joint Committee report, page 81.

whether such expenditure will be factored into the franchisor's decision to renew the franchise term. The package of reforms announced by the Government in amending the Franchising Code and establishing the ACL, including introducing enhanced enforcement powers for the ACCC, should also assist in this area.

### **Unforeseen capital expenditure generally**

Franchisees will be required, at times, to undertake capital expenditure to remain competitive and responsive to market demands, franchise improvements and regulatory changes. The panel considers that, generally, both franchisors and franchisees will work collaboratively to maintain the quality of the franchise infrastructure and equipment. Flexibility is necessary to maintain the integrity of the franchise brand. Parties should be free to negotiate their own franchise agreements as they are in the best position to assess what expenditures need to be undertaken.

However, the panel notes that unforeseen capital expenditure may be imposed on franchisees at a time where the franchisee is not in the best position to incur the cost. Franchisees who have invested considerable resources and time in the business argue that they do not have the freedom to choose whether to undertake the capital expenditure on the basis that the franchisor will use this as a reason not to renew their agreement.

The Government's response to the Joint Committee report commits to amending the Franchising Code to require franchisors to disclose to prospective franchisees the process that will apply in determining end-of-term arrangements (Recommendation 5). To assist franchisees in accessing essential information before becoming psychologically<sup>191</sup>, financially and legally committed to the franchise business, it may be desirable to build on this amendment by inserting an item relating to unforeseen capital expenditure. Such an item might require franchisors to disclose whether or not a significant capital expenditure imposed on the franchisee towards the end of the franchise term would be a factor to be considered by the franchisor in renewing the franchise agreement, or in negotiating an exit payment (if any), and whether this has been a factor in the franchisor's decisions in the past three years of the franchise system.

That said, the panel considers that these changes to the disclosure requirements – in particular the closing of the loophole identified in item 13.6 – together with the enhanced enforcement and investigative powers of the ACCC, may assist franchisees who are required to undertake significant capital expenditure without the security of knowing whether or not their agreements will be renewed. Again, due to the interrelatedness of this and other behaviours, these measures should be viewed as part of a holistic approach to addressing the problems that have been identified. All these measures will contribute to the effectiveness of the franchising model by allowing franchisees to assess and mitigate risks appropriately.

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191 Submission by Jenny Buchan of the University of NSW to the SA Parliamentary Economic and Finance Committee, page 2. Ms Buchan discussed the timing of disclosure as being important before the prospective franchisee is 'psychologically fully committed to become a franchisee'.

### III FRANCHISOR-INITIATED CHANGES TO FRANCHISE AGREEMENTS WHEN A FRANCHISEE IS TRYING TO SELL THE BUSINESS

#### Key points

- Franchisors may need to introduce changes to their franchise agreements, even approaching sale by the franchisee, for legitimate business reasons such as ensuring uniformity in the franchise brand, reflecting changes in the market, and complying with changes in the regulatory environment or industry standards.
- When a prospective franchisee signs an agreement, they are entering into their own arrangement with the franchisor. They are not entering the same agreement the current franchisee signed at the beginning of the term. However, changes to a franchise agreement when a franchisee is trying to sell the business may impact on the franchisee's capacity to maximise their returns on investment.
- Improved up front disclosure and education on the processes that will apply if a franchisee seeks to sell the business may assist franchisees in undertaking due diligence.

#### Identifying the problem

During consultations, concerns were raised over franchisor-initiated changes to the terms of an agreement when the franchisee is seeking to sell to a prospective franchisee. Changes made to an agreement can affect the viability of a franchise unit which may in turn, impede the sale. The time associated with negotiating any changes or providing franchisors with additional information may also hinder the sale of a franchise unit.

The Government response to the Joint Committee report recognised that franchisors need to make commercial decisions to maintain and revitalise their franchise model. While acknowledging the commercial nature of franchising, the Government's response also recognised that changes to a franchise agreement when a franchisee is trying to sell the business may impact on the franchisee's ability to maximise the return on their investment.

The panel notes that this issue is closely related to the issues of unilateral contract variation and unforeseen capital expenditure, which have already been discussed. The ability of a franchisor to change the terms of the franchise agreement when the franchisee is trying to sell the business can stem from a clause in the agreement or the operations manual which gives the franchisor a power to unilaterally vary a franchise agreement. Moreover, if that variation involves capital expenditure this may have a material influence on the franchisee's prospects of sale. As such, many of the issues previously discussed are also relevant to the analysis in this section.

The Franchising Code stipulates that a request for a franchisor's consent to transfer a franchise must be made in writing<sup>192</sup> and a franchisor must not unreasonably withhold

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192 Franchising Code, clause 20(1).

consent to the transfer.<sup>193</sup> The franchisor is taken to have given consent to the transfer if the franchisor does not, within 42 days after the request was made, give to the franchisee written notice:

- (a) that consent is withheld; and
- (b) setting out why consent is withheld.<sup>194</sup>

The panel acknowledges that there is limited data on the prevalence and extent to which franchisors make changes to an agreement when a franchisee is trying to sell. The panel notes that franchisor initiated changes may occur both at the transfer of an existing franchise agreement or as a part of arrangements that represent the novation of the current franchisee's agreement with the prospective franchisee signing a new franchise agreement.

During the Joint Committee inquiry, the Committee received submissions outlining circumstances in which franchisees found it difficult to sell their business. Mr Peter Judkins, CEO, Lottery Association of Victoria noted in his submission that in some circumstances, franchisors may draw out the approval process, making the franchisee's business difficult to sell:

The transfer of [blanked out] accreditations can sometimes take as long as six months – an impossibly long period for people who have left a job or sold a business and who are waiting for the approvals process to be concluded so as to buy a [blanked out] franchise.

It is open to a franchisor to continually procrastinate by seeking additional information from an applicant – no matter how minor – then claim that the application was incomplete and that the 42 day rule does not begin to come into contention until there is a complete application.<sup>195</sup>

Franchisees who wish to sell their business may do so for many reasons. For instance, a franchisee may no longer be able to operate their franchise business for personal reasons, or may no longer believe that it is a viable business.

Selling the business may enable the franchisee to obtain a higher price from a third party than they may have otherwise received. It may also enable them to maximise the return on their investment.

While the franchisor must disclose to a prospective franchisee any arrangements as they relate to the franchisee's goodwill, if any, on termination or expiry,<sup>196</sup> there is no requirement in the Code for a franchisor to make a goodwill payment to the franchisee upon the franchisee exiting the franchise. Any allocation of goodwill is up to the parties to negotiate.

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193 Franchising Code, clause 20(2).

194 Franchising Code, clause 20(4).

195 Submission (number 45) from the Lottery Agents Association of Victoria to the Joint Committee, page 4.

196 Franchising Code, Annexure 1, item 17(g).



The panel notes that the considerations stemming from the Government response may provide franchisees with further information on exit payments. Disclosure of end-of-term arrangements may provide assistance to prospective franchisees at the time when they are considering entry to the franchise system, as there are fewer unknowns in their own individual cost-benefit analyses.

The Government has announced amendments to the Franchising Code to require franchisors to disclose to prospective franchisees the process that will apply in determining end-of-term arrangements and what, if any, exit payments will apply.<sup>197</sup> The Government noted that any exit arrangements should give due regard to the potential transferability of equity in the value of the business as a going concern. Without limiting the items that would need to be disclosed when developing end-of-term arrangements, the Government response noted that the following issues should be considered<sup>198</sup>:

- Would the prospective franchisee have any options to renew or extend the agreement beyond the original term? If so, what processes would the franchisor use to determine whether or not to renew or extend the agreement?
- Information on whether or not the prospective franchisee would be entitled to an exit payment at the end of the term and, if so, how the exit payment would be determined and/or earned.
- Details on what arrangements would apply to unsold stock, or equipment purchased at the beginning of the term, at the end of the agreement. For example would the franchisor buy the stock and/or equipment back at the end of the term? If so, how would price be determined?
- Details on whether or not the prospective franchisee would have the right to sell the business at the end of the term. If the franchisor would have first right of refusal on any right to sell the business, how would market value be determined?

These amendments are currently being drafted. While the Government has expressed its intent regarding the amendments, it is unknown how the sector will react to such changes. However, at the least, a more complete understanding of end-of-term arrangements will provide more structure and transparency for discussions between franchisors and prospective franchisees, particularly with respect to the scope for recouping investments.

### Stakeholder perspectives

The ability of franchisors to change the terms of the agreement at the time of sale and the delays associated with making these changes,<sup>199</sup> can be problematic for those franchisees

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197 Government response to the Joint Committee report, page 14.

198 This list is not intended to be exhaustive or indicative of information that must be provided by a franchisor in their disclosure document. The Government recognises that information provided by franchisors in detailing their end-of-term arrangements is a commercial matter that is best determined by the individual parties.

199 For example, see submission (number 45) from the Lottery Agents Association of Victoria to the Joint Committee, page 4.



who are wishing to sell the franchise. These changes can also make the franchise less attractive to prospective franchisees; for example, changes could reduce the term of the agreement, reduce the territory of the agreement and/or reduce the potential return on investment for prospective franchisee. Franchisees may feel that by making the franchisee business less attractive they are potentially receiving less returns on their investment.

Many of the franchisor perspectives will be similar to those expressed under unilateral contract variation. Franchisors may wish to re-negotiate the terms of a franchise agreement at the time of sale given they are entering into a new relationship and this provides a good opportunity to outline the rights and responsibilities of each party. It is also possible that any changes introduced at the time of sale represent changes that the franchisor has already introduced into its other agreements.

### **The panel's view**

The panel notes that there is limited data available on both the prevalence and extent to which franchisors introduce changes to an agreement when a franchisee is trying to sell the business. The panel considers that while there may be a power imbalance in the franchising relationship, it would likely be in the best interest of both the current franchisee and the franchisor to seek to expedite the sale of the franchised business. The panel also notes that franchisor initiated changes may arise during two different circumstances:

- the transfer of a franchise agreement; and
- the novation of the current franchisee's agreement and the execution of a new agreement with the prospective franchisee.

The panel recognises the potential difficulties current franchisees may face if their franchisor introduces changes when they are trying to sell the franchise. However, the panel also recognises that when a prospective franchisee signs an agreement they are entering their own arrangement with the franchisor; they are not entering the same agreement the current franchisee signed at the beginning of their term. As this would represent a new arrangement, there may be differences between the current and prospective franchisee agreements.

This is inherent in the relationship between a franchisor and a prospective franchisee: an agreement is to be entered into between the two, the franchisor has a certain degree of bargaining power and uses it to request certain terms, and the franchisee accepts, negotiates or declines to enter the agreement. There is always a risk, then, that a new franchisee's agreement will be different from the previous franchisee's, just as it may differ from other of the franchisor's franchisees. As an important risk in the relationship, it is a factor that should be disclosed to prospective franchisees and allowed to enter their decision-making processes.

The panel recognises the importance of allowing franchisors to introduce changes to their agreements to ensure both uniformity in the franchise brand and to reflect changes in the market. The panel is therefore of the view that the most appropriate approach to this issue is to ensure there is adequate upfront disclosure, for prospective franchisees, on the processes that will apply if a franchisee seeks to sell the business.

The panel notes that clause 20 of the Franchising Code outlines the requirements relating to the transfer of a franchise agreement. The panel recommends that the Government consider amendments to clause 20 (or elsewhere in the Franchising Code) to cater for novation of a franchise agreement in addition to transfer of a franchise agreement. In particular, the Government should consider whether there are any circumstances in which it is always unreasonable to withhold consent to the transfer of a franchise agreement. It was suggested to the panel in the course of stakeholder consultation that these circumstances might be incorporated specifically into clause 20, which already contains a list of circumstances where it is reasonable to withhold consent. This may be a difficult process, noting that where conduct is extremely unreasonable the unconscionable conduct provisions of the TPA would likely provide a remedy. However, the proposal may usefully be incorporated into the Government's consideration of how to implement its announced improvements to disclosure of end-of term arrangements.

The Government has announced its intention to amend the Franchising Code to require franchisors to disclose to franchisees the process that will apply in determining end-of-term arrangements and what, if any, exit payments will apply. These amendments may provide franchisees with information on whether or not they would have the right to sell the business at the end of the term, and on what basis. They may also provide additional information to franchisees on the processes that will apply should they seek to sell their franchise.

The panel also recommends that the ACCC consider whether additional educational activities are required in this area.

## IV ATTRIBUTION OF LEGAL COSTS

### Key points

- Clauses attributing legal costs can be found in a wide variety of industry and business agreements and, as such, an outright prohibition is not appropriate.
- The existence of a clause that results in the attribution of legal costs to one party may serve as a significant financial disincentive for the affected party to initiate dispute resolution procedures or legal action against the other party, particularly where the cost of action is already prohibitive.
- The Franchising Code provides that parties are equally liable for the costs of mediation unless they agree otherwise. However, there may not be meaningful agreement where an imbalance of bargaining power exists between the franchisor and franchisee.
- The Franchising Code also provides that parties must pay for their own costs of attending mediation. The Code is not clear on whether 'costs' includes costs incurred in preparing for mediation.
- Greater disclosure and education may be required before parties enter into an agreement, to ensure that prospective franchisees are conscious of the use of cost-attribution clauses in franchising agreements and their potential impacts. This disclosure and education needs to be provided in a meaningful manner, and early in the decision making process to enable prospective franchisees to undertake their due diligence.
- The issue of attribution of legal costs would usefully form part of any future review of small business dispute resolution systems.

### Identifying the problem

During franchising consultations, concerns have been raised about some franchise agreements including a requirement for the franchisee to pay the franchisor's legal costs and other expenses incurred in the enforcement of the agreement. Consultation has suggested that these types of clauses may also be used by franchisors to require franchisees to pay the costs incurred as a result of mediation under the Franchising Code.

The Government response to the Joint Committee report noted that parties engaged in trade and commerce should have a high degree of freedom to contract as they see fit, on the basis that the parties to a contract are best placed to determine commercial matters. However, the Government response also recognised the need to encourage parties to a franchise dispute to approach their dispute in a reconciliatory manner, and that clauses that result in the attribution of legal costs to one party (such as a franchisee) could provide a significant financial disincentive for the affected party to initiate dispute resolution procedures or legal action against the other party.

There are two main circumstances in which attribution of legal costs clauses may arise as an issue:

- franchisees may be required to pay the franchisor's legal costs incurred in dispute resolution; and
- franchisees may be required to pay the franchisor's costs incurred as a result of mediation specifically.

#### **Attribution of costs in dispute resolution**

The existence of a clause attributing legal costs to the franchisee may serve as a significant financial disincentive for the franchisee to initiate legal action against the franchisor. Concerns regarding access to mediation and formal legal proceedings arise in this context. Professor Elizabeth Spencer noted in her submission to the SA franchising inquiry that the Office of the Mediation Adviser has previously indicated that few of the disputes that fail to settle through mediation go on to litigation.<sup>200</sup>

It appears, then, that given the costs involved, litigation may not always be an option for franchisees. Furthermore, litigating a dispute carries an in-built risk, as an unsuccessful application for relief may result in a decision that the applicant pay the other's cost. The viability of a franchisee pursuing legal action to enforce their franchise agreement would likely diminish further if the franchise agreement indicates that the franchisor can recover all the costs associated with its enforcement of the agreement (that is, recover costs on a solicitor/client basis rather than on the more limited party/party basis likely to be awarded by the court absent an alternative contractual intention).

The panel understands that the decision to implement the Franchising Code as a mandatory code was influenced by a desire to address the major problems in the sector, including the high cost of actions under the TPA and the difficulties experienced by franchisees in obtaining redress from an infringing franchisor.<sup>201</sup> As such, the inclusion of a clause requiring a franchisee to pay for the franchisor's legal costs could diminish the Franchising Code's objective to reduce the cost of resolving disputes in the sector by unfairly disadvantaging one party over the other.<sup>202</sup>

Conversely, it was put to the Joint Committee that some franchisees may use litigation, or the threat of proceedings as 'a form of commercial blackmail'.<sup>203</sup> Under item 4.1 of Annexure 1 to the Franchising Code, a franchisor is required to disclose details of existing litigation or arbitration proceedings in their disclosure documents to prospective and current franchisees. Since negative feedback on a franchise system may harm the franchise's brand name and discourage potential franchisees, franchisors have a significant interest in settling such

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200 Submission by Professor Spencer to the SA Parliamentary Economic and Finance Committee, page 10.

201 Explanatory Statement, *Trade Practices (Industry Codes - Franchising) Regulations 1998*.

202 *ibid.*

203 Submission (number 105) from 7-Eleven Stores to the Joint Committee, pages 4-5.

disputes. It has been suggested that some franchisees may use the requirements in item 4.1 to compel their franchisors to settle by raising spurious or vexatious claims.<sup>204</sup>

The prevalence of clauses attributing legal costs to one party to a franchising agreement is unclear. However, consultation suggested that clauses providing that legal costs are to be borne by one party, irrespective of the outcome of legal action, are not common.

The panel also notes that attribution of legal costs clauses can be found in a wide variety of industry and business agreements and, in many cases, may represent a genuine business need. Accordingly, the panel has been mindful of the possible implications that prohibition or regulation of the attribution of legal costs in the enforcement of a franchise agreement may have on the wider business community and other industry codes.

### **Attribution of costs in mediation**

Currently, the Franchising Code provides that ‘parties are equally liable for the costs of mediation under [Part 4 of the Code] unless they agree otherwise’<sup>205</sup>, and the parties ‘must pay for their own costs of attending the mediation’.<sup>206</sup> The Franchising Code further provides that the provisions relating to Part 4 do ‘not affect the right of a party to a franchise agreement to take legal proceedings under the franchise agreement.’<sup>207</sup> However, a submission to the South Australian inquiry into franchising noted that, similar to litigation, the cost of mediating a dispute with a franchisor can be prohibitive.<sup>208</sup>

As one of the objectives of the Franchising Code is to ‘reduce the cost of resolving disputes in the sector’,<sup>209</sup> the inclusion of a clause requiring the franchisee to cover all costs of mediation could detract from the Code’s emphasis on accessible, low-cost dispute resolution. Similarly, such a clause may deter parties to a franchise dispute from approaching their dispute in a reconciliatory manner.

In comparison, other submissions to the Joint Committee suggested that there is potential for a franchisee to frustrate the intention of the dispute resolution system, by bringing spurious claims.<sup>210</sup> For instance, it was suggested that the law is in the franchisees’ favour and that franchisees only have to make allegations of being misled or mistreated to cause problems for the franchisor.<sup>211</sup>

However, the Joint Committee noted the view that franchisees ‘often feel they have no choice but to accept whatever mediation terms they are offered’.<sup>212</sup> In its submission to the Joint Committee, the Franchisees Association of Australia suggested that:

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204 Submission (number 105) from 7-Eleven Stores to the Joint Committee, pages 4-5.

205 Franchising Code, clause 31(2).

206 Franchising Code, clause 31(3).

207 Franchising Code, clause 31(1).

208 Submission by Mr Scott Cooper to the SA Parliamentary Economic and Finance Committee, page 53.

209 Explanatory Statement, *Trade Practices (Industry Codes - Franchising) Regulations 1998*.

210 Joint Committee report, page 90.

211 Submission (number 144) from Fibrecare Group to the Joint Committee, page 9.

212 Joint Committee report, page 91.

The truth is that many franchisees settle, but only in despair, having no alternative, especially given the imbalance in bargaining power.<sup>213</sup>

Statistics provided by the Office of the Mediation Adviser (OMA) indicate that, on average, mediation costs each party approximately \$1,500.<sup>214</sup> However, these costs are indicative only of the time spent directly in mediation, and do not take into account any preparation or legal advice costs on the part of the franchisor or franchisee.

### **The panel's view**

The panel is aware that attribution of legal costs clauses can be found in a wide variety of industry and business agreements, and that there may be legitimate business reasons to include such a clause, which might be reflected for example in a lower franchise fee under the agreement. Consequently, the panel is hesitant to suggest that steps should be taken to prohibit or restrict such provisions in franchising, without fully understanding the possible implications for the wider business community.

### **Costs in the context of dispute resolution**

As a general rule, the panel does not object to the attribution of legal costs, which can in any case be a legitimate outcome of a settlement of a dispute. Parties may freely agree, alone or with the assistance of a mediator or court, to settle their dispute in any number of ways, and one aspect of that settlement may be that one party pay the other's costs (however assessed). Further, a declaration that attribution of legal costs should be prohibited would likely be ineffective, given that the costs incurred by parties engaged in a dispute inevitably feed into their consideration of the terms upon which they would be prepared to settle.

This highlights that it is undesirable to consider the attribution of costs divorced from the context within which costs are incurred: the dispute. Costs may be sensibly attributed to one party in some circumstances (for example, a franchisor may have an incentive to cover the full cost of mediation in order to foster effective and meaningful negotiation), while in other circumstances it would appear unreasonable to do so, depending largely on the nature of the dispute, the mechanism through which the dispute is resolved, and the method by which costs are sought to be addressed.

It is undesirable to consider one aspect of dispute resolution (costs) in isolation from the broader context of the dispute resolution process.<sup>215</sup> Accordingly, it is the panel's view that cost attribution clauses could be taken into account as part of any future consideration by the Government of the dispute resolution processes across the small business sector. Furthermore, it is recommended that Australian governments consider opportunities to enhance and harmonise dispute resolution facilities available to small business. The issue of cost-attribution may sensibly form part of that consideration. Further empirical research may assist an understanding of the circumstances in which the attribution of costs may and may not be legitimate, including where costs are attributed irrespective of outcome.

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213 Submission (number 51) from the Franchisees Association of Australia to the Joint Committee, page 18.

214 Submission (number 137) from the Department of Innovation, Industry, Science and Research to the Joint Committee, page 3.

215 See Chapter 4 for a discussion of various aspects of small business dispute resolution.

### Costs in the context of mediation under the Franchising Code

The starting position in the Franchising Code, as provided in subclause 31(2), is that the costs of mediation are to be shared, unless the parties themselves agree otherwise. While this provision recognises that parties are free to contract on this point as they see fit, and that there may be legitimate reasons to negotiate away from the status quo, the panel is concerned that, in some circumstances, the ‘agreement otherwise’ may not be a meaningful agreement. While the panel understands that there ‘is an inherent and necessary imbalance of power in franchise agreements’,<sup>216</sup> it is also conscious of how the unequal distribution of bargaining power may affect the attribution of legal costs. For instance, the panel is aware of the lack of mutuality in the operation of these clauses (that is, that they may be in one party’s favour).

Accordingly, although the panel does not support an outright prohibition on clauses attributing legal costs, it encourages greater and more meaningful disclosure. Where a franchisor is likely to seek to attribute their costs to a franchisee in the event of dispute resolution, then this should be disclosed up front and at a time in the decision-making process that enables prospective franchisees to undertake their due diligence.

Furthermore, the panel notes that, currently, it is not clear under the Franchising Code what ‘costs’ refers to in the context of subclause 31(3). As indicated previously, statistics suggest the cost of the mediation service itself is approximately \$1,500 per party. However, the costs of mediation may, on one reading, include all the costs leading up to mediation, including travel and accommodation, legal or other advice, and so on. It is not clear what was intended to be covered by ‘costs’ under this provision, and the provision would benefit from clarification on this point.

The panel also notes that any future consideration of the effectiveness of dispute resolution mechanisms should adopt a holistic approach when examining the prevalence of clauses attributing legal costs. This process should, optimally, reflect that a variety of different costs clauses may arise in a diverse range of industries and across a spectrum of different cost recovery situations.

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216 Joint Committee report, page 101.



## V CONFIDENTIALITY AGREEMENTS

### Key points

- Confidentiality clauses are commonly used in ordinary commercial life as a measure to protect commercial interests. It is important to acknowledge the legitimate use of confidentiality agreements in protecting these commercial interests, which may include the franchisor's intellectual property and the outcome of settlement agreements.
- Confidentiality clauses may impact on the effectiveness of two provisions of the Franchising Code:
  - they may effectively prevent past and present franchisees from openly discussing their franchise experiences with prospective franchisees, which frustrates in part the intention of recent amendments to the disclosure regime to require disclosure to prospective franchisees of the names, location and contact details of past and present franchisees (under item 6.4 of Annexure 1 of the Code); and
  - they may effectively prevent franchisees discussing important matters relating to their arrangements with other franchisees in the system, which diminishes the value of (but does not violate) the freedom of association of franchisees and prospective franchisees under clause 15 of the Code.
- Greater disclosure and education before entry into an agreement may assist franchisees ensure that they are more aware of the use of confidentiality clauses in franchising agreements and their potential impacts.

### Identifying the problem

During consultations, concerns were raised that some franchise agreements contain confidentiality clauses that prevent current or past franchisees from discussing important details of their franchise arrangement with other franchisees, or prospective franchisees.<sup>217</sup>

The Government response to the Joint Committee inquiry recognised that confidentiality agreements may be necessary to protect a franchisor's intellectual property. The Government also considered that parties engaged in trade and commerce should have a high degree of freedom to contract. However, in its response, the Government noted that information provided by current and past franchisees can aid prospective franchisees in determining whether or not to enter into the business agreement proposed by the franchisor.<sup>218</sup>

The objectives and consequences of confidentiality clauses can vary depending on the way in which they are imposed on franchisees. There appear to be three main ways in which confidentiality clauses operate:

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217 Government response to the Joint Committee report, page 18.

218 *ibid.*

- Franchisees may be subject to confidentiality clauses that limit the assistance they can provide to prospective franchisees.
- Franchisees may be subject to confidentiality clauses that prevent them from discussing important details of their franchise arrangements with others.
- Franchisees may be subject to confidentiality clauses as a result of current mediation proceedings or as a result of a dispute settlement between a franchisor and their franchisees.

#### **Confidentiality clauses that limit the assistance they can provide to prospective franchisees**

The Joint Committee noted that part of the appeal of franchising for franchisees, is the potential benefit of being able to conduct a business under an existing brand name and prescribed operational system.<sup>219</sup> The Joint Committee also acknowledged that franchisors 'have a genuine need to maintain confidentiality around certain commercial information, in order to protect and advance the interests of the franchise as a whole'.<sup>220</sup>

However, confidentiality clauses may have the effect of preventing past and present franchisees from openly discussing their franchise experiences with prospective franchisees. The Franchising Code requires franchisors to provide prospective franchisees with the contact details of existing and some past franchisees, however, some of these existing and past franchisees may not be free to speak openly with prospective franchisees about certain issues due to the effect of confidentiality agreements.

One stakeholder suggested in comments on the Government Options Paper that:

The code currently requires that name and contact details of ex franchisees be given so long as the ex franchisee has not withheld their consent to publish. There is absolutely no way for a franchisee or potential franchisee to check if perhaps the franchisors [sic] has claimed the previous franchisee withheld consent when actually they did not. This allows a franchisor to avoid potential franchisees coming into contact with ex franchisees who may have negative things to say about the franchisor.<sup>221</sup>

As part of the 1 March 2008 amendments to the Franchising Code, the Government included a provision in the Code that requires franchisors to provide not just the phone numbers but also the names, location and contact details for ex-franchisees corresponding to the events listed in item 6.4 of Annexure 1. This provision is subject to a request by the ex-franchisee that their details not be disclosed. Item 6.4 requires disclosure of:

For each of the last three financial years and for each of the following events – the number of franchised businesses for which the event happened:

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219 Joint Committee report, page 5.

220 Joint Committee report, page 58.

221 Response to the Franchising Code of Conduct Options Paper, released 21 June 2009, name withheld.

- (a) the franchise was transferred;
- (b) the franchised business ceased operation;
- (c) the franchise agreement was terminated by the franchisor;
- (d) the franchise agreement was terminated by the franchisee;
- (e) the franchise agreement was not renewed when it expired;
- (f) the franchise business was bought back by the franchisor; or
- (g) the franchise agreement was terminated and the franchised business was acquired by the franchisor.<sup>222</sup>

The 1 March 2008 amendments were aimed at further bolstering existing provisions in the Franchising Code that required franchisors to disclose the number of current franchisees in the system along with their details (business address, phone number, and number of years in operation).<sup>223</sup>

The explanatory statement to the 1 March 2008 amendments noted that further information on past franchises would be an important aspect of the disclosure process. It was considered that information on ex-franchisees would assist prospective franchisees to obtain advice regarding the viability of the franchise, practical issues in running the franchise business, and level of assistance provided by the franchisor. Further, this information would provide an indication of the level of, and reasons for, movement in and out of the franchise system, which would also likely be relevant to a prospective franchisee.<sup>224</sup> Information about movement in and out of a franchise system would indicate to prospective franchisees whether churning is occurring. The Joint Committee defined ‘churning’ as a practice in which a franchisor sells and re-sells a unit franchise, making a profit each time the business changes hands regardless of the profitability of the unit franchise.<sup>225</sup> The Committee identified churning in its report as a form of ‘franchisor opportunism’.<sup>226</sup> Confidentiality clauses could have the effect of silencing current and past franchisees that have been subject to churning.

Mr Gavin Butler, Director, Track Record Consulting, expressed the same view in his submission to the Joint Committee:

The practice of Franchisors silencing all and sundry through their exit strategies needs to be addressed as it is allowing the practice of ‘churning’ to flourish ... The attachments I am enclosing with this letter need to remain confidential because I too

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222 Franchising Code, Annexure 1, item 6.

223 *ibid.*

224 Explanatory Statement, *Trade Practices (Industry Codes – Franchising) Amendments Regulations 2007 (No. 1)*, page 14.

225 Joint Committee report, page 40 at n 42.

226 Joint Committee report, page 101.

have been required to sign a confidentiality agreement to protect the future interests of the franchisor at the expense of the innocent prospective franchisee.<sup>227</sup>

### **Confidentiality clauses that prevent franchisees from discussing important details of their franchise arrangements with other franchisees**

In a submission to the South Australia parliamentary inquiry, Professor Elizabeth Spencer noted that there may be other commercially-driven reasons why franchisors use confidentiality agreements. Professor Spencer noted that ‘the reputation of a franchisor, including the nature of a franchisor’s management of the system and the relationships within it, is critical to a franchisee in making its decision about buying a franchise’;<sup>228</sup> however, it may be equally critical to existing franchisees. For example, negative feedback from one franchisee may impact on other franchisees or the whole franchise.

A franchisor needs to protect the goodwill in the brand as well as the commercial viability of other franchisees and there could be some circumstances where confidentiality agreements are used to protect the franchise from inappropriate conduct by franchisees. For example, the Joint Committee received suggestions that franchisees may threaten to make unfounded claims against the franchisor, or give negative feedback about the franchisor or the franchise system to prospective franchisees in order to limit the franchisor’s ability to expand its system.<sup>229</sup>

Accordingly, franchisees may also be subject to confidentiality clauses preventing them from discussing aspects of their franchise arrangement with other franchisees. As one stakeholder suggests in comments made on the Government Options Paper:

Even existing franchisees find it very difficult to discover when another franchisee has left the system or how many franchises are for sale or have been terminated ... Existing franchisees also need access to this kind of information to help them determine the health of the system they are in, in terms of the turnover of franchisees exiting the system or changes in the size of the system that could alert them to a system growing too fast or shrinking in size.<sup>230</sup>

The ACCC raised this issue in its submission to the Joint Committee:

The ACCC notes the code prohibits a franchisor from inducing a franchisee not to associate with other franchisees or prospective franchisees for a lawful purpose [clause 15]. However, we are also aware that some franchise agreements contain a confidentiality clause that may prevent important information from being disclosed to existing franchisees or prospective franchisees.

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227 Submission (number 3) from Mr Gavin Butler to the Joint Committee, pages 3-4.

228 Professor Spencer’s submission to the submission to the South Australian Parliamentary Economic and Finance Committee, page 17.

229 Mr Geoffrey Cope, Managing Director of the Fibrecare Group suggested that ‘there is a view amongst franchisees that if they aren’t happy they can get out of their agreements if they cause a bit of a stir’. Submission (number 144) from Fibrecare Group to the Joint Committee, page 9.

230 Response to the Franchising Code of Conduct Options Paper, released 21 June 2009, name withheld.

These kinds of clauses can circumvent the purpose of the code's prohibition against a franchisor inducing franchisees and prospective franchisees not to associate. In particular, a prospective franchisee may be unable to receive full relevant information on whether they should purchase a franchise from a past or current franchisee because of a confidentiality restraint imposed by the franchisor.<sup>231</sup>

Clause 15 of the Franchising Code states that:

A franchisor must not induce a franchisee or prospective franchisee:

- (a) not to form an association; or
- (b) not to associate with other franchisees or prospective franchisees for a lawful purpose.

**Confidentiality clauses as a result of current mediation proceedings or as a result of a settlement of a dispute between the franchisor and its franchisees**

Confidentiality agreements may be used to prevent parties to a dispute discussing details of ongoing mediation proceedings or the terms of a dispute settlement.

Currently, mediation under the Franchising Code is intended to be confidential. The confidential nature of mediation enables both parties to approach their dispute in a reconciliatory manner by allowing them to be open and frank about their issues. Prohibiting confidentiality clauses may reduce the willingness of parties to engage in mediation or may hinder the effectiveness of mediation to facilitate agreeable solutions.

Franchisors may also impose confidentiality clauses on franchisees as part of the terms of settlement to a dispute. There may be different reasons why franchisors and franchisees may prefer to settle disputes rather than proceed to court. Franchisors may wish to settle a dispute privately in order to preserve the franchisor's reputation and brand, while franchisees may prefer to settle a dispute rather than to take the matter to court given the high costs involved. If confidentiality clauses were prohibited there may be less motivation for franchisors to settle their disputes out of court which may have negative implications on franchisees.

Confidentiality clauses of this nature may also have negative consequences for prospective franchisees. For example, one consequence could be to create an artificial pool of franchisees that prospective franchisees can contact while undertaking their due diligence, thus limiting any negative feedback about the franchisor or the franchise.

An anonymous submission to the Joint Committee noted that:

there are a number of failed franchisees who have negotiated 'settlement agreements' with the company in order to get out of their failed franchise ... These 'settlement agreements' often contain 'keep quiet' provisions that prohibit the failed franchisee from discussing the terms of the settlement. This has the affect [sic] of 'gagging' the

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231 'Submission (number 60) from the ACCC to the Joint Committee, page 26.

failed franchisee from sharing his experience with a new potential franchisee ... 'non-disclosure' clauses forced on failed franchisees by the company when closing a store should not be allowed.<sup>232</sup>

While some franchisees cite the use of confidentiality clauses as a way in which franchisors are able to silence former franchisees that have had a negative experience with the franchisor or the franchise system, this line of argument fails to consider that franchisees are subject to other laws – such as defamation laws, unconscionable conduct and misleading or deceptive conduct under the TPA – when they talk with prospective franchisees. These legal mechanisms provide protection to both franchisors and franchisees from unfairly damaging remarks by the other party.

### Stakeholder Perspectives

The purpose of the disclosure document is aimed at helping the franchisee or prospective franchisee to make a reasonably informed decision about the franchise.<sup>233</sup> Confidentiality clauses that prevent current or former franchisees from discussing certain issues with a prospective franchisee could affect the prospective franchisee's capacity to thoroughly investigate the franchise system. This may in turn impede the effectiveness of the Franchising Code's disclosure provisions.

Information about current franchisees' experiences is important not only to prospective franchisees, but also current franchisees. Confidentiality clauses preventing current franchisees from discussing important matters relating to their arrangements with other franchisees in the system may prevent current franchisees from obtaining important information about the health of the system. This may in turn reduce franchisees' ability to make informed decisions about whether or not to renew their franchise agreements.

However, confidentiality clauses in franchise agreements are a valid means of protecting the franchisor's intellectual property and trade secrets. Further, confidentiality clauses as a result of a dispute or settlement provide franchisors with an incentive to settle disputes outside of court and thus encourage franchisors to participate fully in mediation.

### The panel's view

While the panel has considered stakeholders' views relating to concerns about the use of confidentiality clauses in franchising, it notes that there is limited empirical evidence as to the extent to which confidentiality clauses pose a problem in franchising. The panel also notes that confidentiality clauses are used in a wide variety of industries and business agreements, and in many cases represent a genuine business need to protect assets such as intellectual property, including trade secrets.

Therefore, in the panel's consideration of this issue, it has been mindful of the possible implications that regulatory measures may have on the wider business community and other industry codes. It is also aware of the negative reputation likely to be generated for

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232 Submission (number 63) – name withheld – to the Joint Committee, pages 3-4.

233 Franchising Code, clause 6A.

franchisors that take an excessively restrictive approach to confidentiality, which serves as a natural disincentive to abuse of confidentiality agreements.

The panel supports the legitimate use of confidentiality agreements as part of ordinary commercial life, particularly as a measure to protect intellectual property and other commercial interests. For instance, a franchisor has a legitimate interest in protecting its intellectual property and trade secrets from actual or potential competitors. While there may be opportunities to prevent their misuse, it is important to avoid disproportionate responses such as an outright prohibition, or a provision protecting legitimate interests which merely provoke definitional disputes about what is a legitimate interest.

Certainly, while the panel considers the protection of intellectual property is the most significant legitimate purpose for confidentiality agreements, there are other legitimate interests that may be protected. However, it is not feasible to construct an exhaustive list of those interests, particularly given that the franchising sector encompasses a wide variety of industries where commercial interests may vary. Since there are legitimate interests that confidentiality clauses may protect, it is not appropriate to consider an outright prohibition of such clauses, or a prohibition that carves out intellectual property as the sole interest which may be protected through confidentiality clauses.

The panel considers that an alternative to prohibition is to address the information asymmetry created by the use of confidentiality clauses in franchising. The panel recognises that for franchisees to carry out their due diligence they require access to the relevant information to enable them to make good business decisions including information on the use and likely implication of confidentiality clause.

The panel notes that concerns over the use of confidentiality clauses in franchising was also an issue canvassed in a recent review of the United States Federal disclosure provisions and Franchise Rule.<sup>234</sup> The United States Federal Franchise Rule (16 CFR. Part 436) was amended in May 2008 to address these concerns and disclosure documents are required to include the following statement:

In some instances, current and former franchisees sign provisions restricting their ability to speak only about their experience with [name of franchise system]. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you.<sup>235</sup>

The panel considers there may be merit in inserting a similar statement in the Franchising Code as a requirement for franchisor disclosure.

The ACCC has suggested that confidentiality clauses 'can circumvent the purpose of the code's prohibition against a franchisor inducing franchisees and prospective franchisees not

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234 Federal Trade Commission, *Disclosure requirements and prohibitions concerning franchising*, Staff Report to the Federal Trade Commission and proposed Trade Regulation Rule, Bureau of Consumer Protection, August 2004.

235 Federal Trade Commission, *Franchise Rule (16 CFR Part 436): Compliance Guide*, May 2008, page 107.



to associate'.<sup>236</sup> While confidentiality clauses may not prevent franchisees from associating with other franchisees, they may restrict the type of information that an existing franchisee can discuss with other franchisee.

The panel believes that inserting a statement into the Franchising Code alerting prospective franchisees to the use of confidentiality clauses, and the type of information they typically cover, should mitigate these concerns. The panel notes that such a statement could also include additional information on the categories of information that cannot be discussed, for example outcomes of mediation, settlements or particular aspects of individual agreements such as fees. Subject to these restrictions, the panel recommends a greater level of transparency where possible.

This information may assist franchisees to be more aware of the use of confidentiality clauses in franchising arrangements and their potential impacts.

## **FURTHER MEASURES**

### **Enhanced disclosure**

In response to several of the individual behaviours discussed in this chapter, the panel has formed the view that improved disclosure by franchisors would go a considerable way towards addressing legitimate concerns in the sector, and to better informing the business decisions of franchisees and prospective franchisees. To the extent that these businesses find themselves unable to assess their risks appropriately, improved disclosure could facilitate that assessment. These recommendations should not be viewed in isolation, but as an holistic package directed to improving disclosure in areas where there are key risks for franchisees.

The panel has identified areas where improved disclosure might be desirable. The panel has indicated the broad direction of its disclosure proposals. Wherever the panel has noted its support for disclosure, its support is for disclosure that is not unduly burdensome on either party and can be provided in a meaningful way. That is, the panel supports appropriately targeted disclosure that would not require the franchisor to undertake onerous record-keeping processes or produce complex documentation.

The panel notes that there are practical difficulties associated with disclosing information that may be speculative or contingent on developments that arise throughout the franchise term. For example, unforeseen capital expenditure may be difficult to disclose, given that any information provided about the future may be speculative, and judgments may have to be made about the relevance of information about previous experience. Given these concerns, the panel's findings are not limited to increased disclosure. See, for example, the discussion elsewhere (particularly in Chapter 4) concerning research, advocacy, guidance and education.

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236 Submission (number 60) from the ACCC to the Joint Committee, page 24.

The panel is conscious of the significant volume of disclosure requirements prescribed by the Franchising Code. For some franchising systems, this disclosure may run to hundreds of pages.<sup>237</sup> In its submission to the Joint Committee, the Franchisees Association of Australia indicated its 'objective of halving most current disclosure documents', which would benefit franchisors by reducing disclosure requirements, and a 'bonus will be the greater likelihood that [disclosure documents] are read and understood'.<sup>238</sup>

In considering options for enhancing disclosure under the Franchising Code, the panel recognises that the Government addressed many of the issues associated with disclosure in its response to the Joint Committee report. While the panel does not recommend broad changes to the disclosure arrangements under the Code (other than those outlined in this chapter), it does consider there to be scope for a short, simpler, 'plain English' document to be provided to prospective franchisees earlier in the process of entering a franchise agreement.

This short document would be of use to prospective franchisees, importantly, before they are psychologically, legally or financially committed to a franchise business. It is not intended that the document would relieve franchisees of the need to carry out due diligence. Rather, this document would emphasise to prospective franchisees the key costs, benefits and risks of the franchise system, while leaving more complete disclosure to the formal disclosure documents already required. Further, the short document would be available at the time it is most important, as research in this area has indicated that prospective franchisees need 'to be in a position to make an informed decision as early as possible in the franchise assessment process'.<sup>239</sup>

Item 1 of both the long- and short-form disclosure documents under the Franchising Code already contains statements of the kind that should be included in this simpler document. However, these statements should be available separately, as a ready reference to the key details of the franchise relationship and an important signpost to things the prospective franchisee needs to consider. Importantly, the statement the Government proposes to introduce that 'franchising is a business and that like any business the franchise (or franchisor) could fail during the franchise term'<sup>240</sup> is an important signal to prospective franchisees that a franchise is not a risk-free venture. Similarly, any disclosure related to unforeseen capital expenditure, or unilateral contract variation through the operations manual, could usefully be included in this document.

The panel does not necessarily consider that this document need be mandated by legislation. Instead, it encourages the industry to develop a document in line with the mutual business interests of franchisors and franchisees. However, the Government should consider mandating a short disclosure document of this kind if evidence emerges of systemic

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237 See the Joint Committee report, pages 40-1.

238 Submission (number 51) from the Franchisees Association of Australia to the Joint Committee, page 6.

239 Giddings, J, Frazer, L, Weaven, S and Grace, A, 'Understanding the dynamics of conflict within business franchise systems' (2009) 20 *Australian Dispute Resolution Journal* 24, page 27.

240 Government response to the Joint Committee report, page 6.

problems indicating that franchisees remain unaware of key risks inherent in their role in the franchise business model.

### Research and advocacy

The following chapter recommends a project to enhance research and advocacy capacity in areas of concern for small business. Several, if not all of the franchising behaviours canvassed in this chapter lend themselves both to more comprehensive examination through enhanced research (to inform future evidence-based policy development), and to further education of all stakeholders through advocacy and guidance.

The panel considers it important that issues specific to franchising and more broadly in other areas of small business are not left unattended, but form part of a comprehensive approach to inform the development of small business policy and ongoing efforts to educate and provide guidance to participants in the franchising sector. This approach is discussed in Chapter 4.

### Findings

3.1 Legitimate commercial reasons exist for the **unilateral variation** of franchise agreements, particularly (but not solely) through amendments to the operations manual. For this reason, it is not appropriate to prohibit unilateral contract variation in the franchising sector.

3.1.1 The panel broadly supports franchisor disclosure of:

- the circumstances in which unilateral variations to their agreement may take place; and
- the circumstances in which the franchisor has unilaterally varied a franchise agreement in the past three financial years.

## Findings (continued)

3.2 **Capital expenditure** may be required of franchisees in order to maintain the competitiveness and responsiveness of the franchise business, and such outlays are not always foreseeable. To prohibit unforeseen capital expenditure would unduly constrain franchisors from making valid commercial decisions, and may not be a proportional response to a potentially confined problem.

3.2.1 In making a decision to enter the franchise, prospective franchisees need to be armed with whatever information is necessary to be able to undertake their due diligence and to fully appreciate whether it will be possible for them to recoup their investments, including investment in the form of unforeseen capital expenditure.

The insertion of a further disclosure item would also require franchisors to disclose whether or not a significant capital expenditure imposed on a franchisee towards the end of the franchise term would be a factor to be considered in end-of-term arrangements and whether that has been a factor in the past.

3.2.2 The panel therefore broadly supports disclosure under the Franchising Code of the possibility of unforeseen capital expenditure by the franchisee, particularly as a result of a franchisor amending the operations manual. This could also require disclosure of whether significant capital expenditure would be a factor to be considered in deciding to renew the franchise agreement.

3.3 Where the **franchisee is seeking to sell its business**, there may be legitimate commercial and regulatory reasons for the franchisor to amend the franchise agreement; these amendments may take effect in some agreements toward the end of the term while in others toward the beginning. It is therefore not appropriate to prohibit this behaviour.

3.3.1 The provisions of the Franchising Code relating to transfer of a franchise agreement could be extended to cover novation of a franchise agreement.

3.3.2 The panel broadly supports up front disclosure of the possibility that a franchise agreement may be amended, even when the franchisee is seeking to sell the franchise.

## Findings (continued)

- 3.4 Clauses **attributing legal costs** may be used for a variety of legitimate business purposes, including allowing the franchisor to facilitate dispute resolution with its franchisees, or allowing the franchisee to bear the risk of disputes arising in return for a lower franchise fee. Similar clauses exist in other industries.
- 3.4.1 However, such clauses may be used for inappropriate purposes. Clauses attributing legal costs irrespective of the outcome are particularly troubling. Where a weaker party is coerced into accepting such terms, the unconscionable conduct provisions of the TPA may apply.
- 3.4.2 The issue of cost-attribution during dispute resolution should be considered as part of an over-all approach to enhancing and harmonising dispute resolution facilities available to small business.
- 3.4.3 There is scope to clarify, in the Franchising Code, the meaning the Government intends to attach to 'costs of mediation', and the circumstances in which parties may agree otherwise than to bear their own costs.
- 3.4.4 The panel broadly supports improved disclosure up front of the cost-attribution of dispute resolution, to enable franchisees to better weigh the risks and rewards of entering a particular franchise system.
- 3.5 **Confidentiality agreements** may be used to advance a number of legitimate commercial interests, including the protection of intellectual property and trade secrets.
- 3.5.1 The panel broadly supports disclosure alerting prospective franchisees to the categories of information that cannot be discussed with existing and former franchisees. This might include, but may not be limited to outcomes of mediation, settlements, intellectual property, trade secrets or particular aspects of individual agreements.
- 3.6 A short, simple, 'Plain English' document should be developed, to be provided to prospective franchisees before they are psychologically, financially and legally committed to entering a franchise agreement. This short document would be a ready reference to the nature of the franchise relationship.
- 3.7 The Government and the ACCC should consider ways to examine the nature and incidence of problems associated with these five behaviours, including through empirical research. This research, and advocacy more broadly, should inform guidance material for the franchising sector. The ACCC should consider whether additional educational activities are required in this area.
- 3.8 In relation to the franchising behaviours raised in this chapter, the provisions of the TPA may provide remedies where appropriate, for example, where the behaviour constitutes unconscionable conduct.

## 4 OTHER MATTERS

### Key points

- ‘Good faith’ is a concept of relevance to unconscionable conduct and franchising relationships. The Government has decided not to introduce a general good faith obligation into the Franchising Code. The Government has also decided to deal with the actual concerns which have been raised in the franchising sector about business conduct by addressing them directly in the Code (as discussed in Chapter 3). Accordingly, the Government’s decision sets the context for the panel’s deliberations.
- Many small business disputes in fact fall outside the bounds of the TPA and the Franchising Code, and would be better dealt with as business disputes and not as breaches of the law which require regulatory action. Jurisdictions should look at ways to develop and harmonise early intervention dispute resolution mechanisms for small business.
- The Government is in the process of examining ways to foster research and advocacy in a consumer context. This process should extend to issues of relevance to small businesses, particularly in terms of the effectiveness of the Franchising Code and statutory unconscionable conduct in protecting their interests. The *pro bono* resources of the legal profession could usefully be encouraged in this direction.

There are some other matters which arise out of the panel’s work, particularly due to the common ground between the regulation of unconscionable conduct and the Franchising Code, and it is important for the panel to note these matters by way of closing this report. In particular, the issue of good faith has relevance to the panel’s work, by virtue of the Joint Committee’s recommendation concerning good faith in franchising and the relevance of good faith as a statutory indicator for unconscionable conduct. Issues surrounding dispute resolution and research and advocacy have also arisen in the course of the panel’s consultation and deliberations, and these are discussed in this chapter for the Government’s consideration.

### LINK BETWEEN UNCONSCIONABLE CONDUCT AND FRANCHISING

The issues dealt with in this chapter arise out of the panel’s consideration of both unconscionable conduct and franchising, and are addressed here rather than as part of its treatment of those issues. It is difficult to deal with unconscionable conduct and franchising

in isolation, and indeed in many legal actions where a breach of the Franchising Code is alleged, so too is contravention of section 51AC.<sup>241</sup>

In its submission to the panel, Competitive Foods suggested that the TPA could ‘specifically provide that a breach [of an industry code] might amount to a contravention of the unconscionability provisions in the Act’.<sup>242</sup> While a breach of the Franchising Code does not automatically correspond to unconscionable conduct, certainly, the TPA does not preclude the same factual circumstances leading to a finding that a corporation has both breached the Code and engaged in conduct that was, in all the circumstances, unconscionable. Indeed successful actions have been brought for breach of the Franchising Code and unconscionable conduct based on largely the same factual scenario.<sup>243</sup>

## GOOD FAITH

Recommendation 8 of the Joint Committee inquiry into franchising concerned the introduction of a general good faith obligation into the Franchising Code. In response, the Government agreed with the intent behind the good faith recommendation,<sup>244</sup> but chose not to pursue a general obligation.

Instead, the Government committed to pursuing ‘more certain and targeted’ improvements to the regulation of franchising.<sup>245</sup> Part of this approach was referring for the panel’s consideration the five behaviours discussed in Chapter 3, in addition to other measures concerning mediation and end-of-term arrangements.

Similarly, the additional comments to the Senate Economics Committee inquiry into unconscionable conduct recommended the introduction of a general good faith obligation into the TPA.<sup>246</sup> The panel acknowledges the existence of ‘some discussion in academic and business circles about the appropriateness of a general duty of good faith in business relationships’, which informed the Government’s decision not to adopt a general duty of good faith in business-to-business relationships.<sup>247</sup>

The panel notes the Government’s decision to introduce an express statement in the Franchising Code providing that ‘nothing in the Code limits any common law requirement of good faith in relation to a franchise agreement to which the Code applies’,<sup>248</sup> which will allow the common law principles to continue to develop. The panel acknowledges the Government’s decision not to define this broad concept by expressly including a general

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241 See for example *Australian Competition & Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253; and the ACCC’s enforcement action against Cheap as Chips Franchising Pty Ltd: ACCC, ‘Franchisees awarded \$82,000 compensation for unconscionable conduct’ (media release, 16 March 2001).

242 Competitive Foods Australia Limited submission, page 4.

243 As the *Simply No-Knead* and ‘Cheap as Chips’ actions illustrate.

244 Page 13 of the Government response.

245 *ibid.*

246 Page 49 of the report.

247 *ibid.*

248 Page 13 of the Government response to the Joint Committee report.



obligation of good faith in the Franchising Code, which applies in many different sectors and contexts.

These decisions frame the panel's work. That is not to say the panel should ignore good faith as it is intrinsically relevant to unconscionable conduct (due to its presence as a statutory indicator) and, less overtly, to the franchising behaviours discussed in Chapter 3.

Consequently, where stakeholders have raised good faith as an issue,<sup>249</sup> the panel has considered their views in the light of their relevance to the development of the measures in the Franchising Code to address the specific behaviours listed in the panel's terms of reference. The panel has made recommendations to clarify the unconscionable conduct provisions and to strengthen the Franchising Code, which are designed to improve the effectiveness of those existing legislative frameworks and to address the specific concerns that have been raised about them.

## DISPUTE RESOLUTION

The Government response to the Joint Committee report discusses problems associated with dispute resolution in the franchising sector, and commits to certain measures to improve conduct in connection with the mediation of disputes.

However, the panel also notes a broader issue with respect to dispute resolution. It is unfortunate but inevitable that disputes will arise in commercial settings. Fair trading laws are generally most effective in mitigating disputes when their provisions are clear and, wherever possible, self-executing. This may avoid disputes arising and ensure that effective forums and mechanisms are available to facilitate resolution of disputes when they do arise.

A small business's resources are more limited than those of a larger business. It has been put to the panel, then, that 'the best solution ... is to give the small business owners the same rights as any other individual in the community', that is, as consumers.<sup>250</sup> One of the things that may be sought by comparing small businesses to consumers is to secure the assistance of the TPA's consumer protection provisions and the ACCC's enforcement resources.

However, the ACCC is not empowered or resourced to take action in every complaint brought to it by a consumer, any more than it is in every complaint brought by a small business. The ACCC exists to carry out its functions under the TPA, which include but are not limited to bringing enforcing action where appropriate. Its role does not encompass arbitrating every commercial dispute that arises involving a small business, or even every commercial dispute that involves an alleged breach of the TPA.

However, there is a place in the business environment for bodies that do take an interest in commercial disputes. Several industries have ombudsman schemes, such as the

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249 For example, Professor Zumbo submission, page 9; RTAWA submission, page 3; Post Office Agents Association Limited submission, page 8.

250 National Independent Retailers Association, page 3.

Telecommunications Industry Ombudsman (TIO)<sup>251</sup> and the Financial Ombudsman Service.<sup>252</sup> While these are primarily directed towards consumers, their services are generally open also to small business consumers. The TIO, for example, would be an appropriate forum for a small business to bring a dispute about the supply of telephone services to the business. Only in the worst of circumstances should such a dispute attract the attention of the ACCC<sup>253</sup>; in other circumstances an ombudsman service may be better suited to examining the dispute and arriving at mutually acceptable outcomes.

It is worth noting the role of the Victorian Small Business Commissioner (VSBC), and the WA Small Business Development Corporation in assisting small businesses in their jurisdictions. The panel acknowledges and thanks these organisations for the extensive assistance they have provided, in the course of this process, by way of submissions and information. NSW, of course, also has a successful Small Business Development Corporation operating in its jurisdiction.

Organisations of this kind are a significant means of fostering improved business conduct in relation to small business, and particularly by way of reducing or mitigating disputes. This is illustrated by various of the statutory functions of the VSBC, which include:

- (a) to facilitate and encourage the fair treatment of small business in their commercial dealings with other businesses in the marketplace;
- (b) to promote informed decision-making by small business in order to minimise disputes with other businesses;
- (c) to receive and investigate complaints by small businesses regarding unfair market practices and mediate between the parties involved in the complaint; and
- (d) to make representations to an appropriate person or body on behalf of a small business that has made a complaint referred to in paragraph (c).<sup>254</sup>

The VSBC also has specific dispute resolution functions under the *Retail Leases Act 2003* (Vic)<sup>255</sup> and the *Owner Drivers and Forestry Contractors Act 2005* (Vic).<sup>256</sup>

Small businesses often operate only in one jurisdiction, which may explain the interest of state governments in establishing such bodies as the VSBC. It is therefore appropriate that the States and Territories provide mechanisms facilitating early intervention in small business disputes, and the VSBC and Small Business Development Corporation represent an effective model of achieving that end.

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251 See [www.tio.com.au](http://www.tio.com.au).

252 See [www.fos.org.au](http://www.fos.org.au).

253 See ACCC, 'ACCC alleges hidden contracts, misleading conduct in telecommunications' (media release, 2 October 2008).

254 *Small Business Commissioner Act 2003* (Vic), subsection 5(2).

255 See Part 10 of the Act.

256 See section 54 of the Act.

In its recent review of statutory conditions and warranties, the Commonwealth Consumer Affairs Advisory Council recommended state and territory governments develop a consistent approach for dispute resolution with respect to the new statutory consumer guarantees.<sup>257</sup> A similar approach is appropriate for small business dispute resolution.

Given the adoption of a single unconscionable conduct law in the ACL, governments may wish to examine ways to provide uniform, improved, inexpensive and rapid access to early intervention dispute resolution mechanisms across Australian jurisdictions. To the extent that the Australian Government may be minded, at any time, to examine issues related to early-intervention dispute resolution, the issues discussed in this report relating to dispute resolution should form part of that process. In particular, consideration should be given to the issue of contractual attribution of legal costs between parties to a dispute.

## RESEARCH AND ADVOCACY

On 8 May 2009, the previous Minister for Competition Policy and Consumer Affairs released an issues paper, *Consumer voices: Sustaining advocacy and research in Australia's new consumer policy framework*. The paper canvasses a range of options for fostering effective advocacy and research, and maintaining ongoing discussion and debate, in the field of consumer policy.

The panel believes that this should extend to the understanding of issues affecting small business interests, particularly in terms of the most vulnerable small businesses. An increased focus on research in the sector might, for example, gather the empirical evidence necessary to assess more accurately the extent of the problems in franchising analysed in Chapter 3, as well as other problematic behaviours affecting small businesses generally. There may also be opportunities to gather evidence about the effectiveness of the legal frameworks for protecting small business interests, including the effectiveness of disclosure regimes such as that in the Franchising Code.

In terms of unconscionable conduct, one submission to the Senate Economics Committee inquiry suggested that research of this kind should be undertaken 'to assess the extent to which the public policy objectives of Part IVA have been achieved and if they have not been achieved why this is the case'.<sup>258</sup> The panel agrees with this proposition.

The panel notes the existing resources directed toward small businesses, particularly, for example, the state and territory government small business development corporations. The ACCC is also engaged in efforts to gather information about small business interests and the incidence of disputes, particularly with respect to franchise businesses.<sup>259</sup>

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257 Commonwealth Consumer Affairs Advisory Council, *Consumer rights: Reforming statutory implied conditions and warranties*, October 2009, page 74.

258 Mr Liam Brown's submission to the Senate inquiry, page 2.

259 See for example Giddings, J, Frazer, L, Weaven, S and Grace, A, 'Understanding the dynamics of conflict within business franchise systems' (2009) 20 *Australian Dispute Resolution Journal* 24, which discusses research into conflict in franchising being supported by the Australian Research Council, Griffith University and the ACCC.

As a starting point, the panel suggests that these existing initiatives might be an appropriate mechanism to pursue further research and gather more data on the sector, to inform any future policy development in this space. This is also consistent with the Government's announced support for the ACCC to publicise relevant small business and franchising data.

Additionally, there may be *pro bono* resources from the legal profession that can be turned to this purpose. Certainly, the panel notes the considerable interest that some lawyers and legal academics have taken in the two inquiries that led to this panel's formation, as well as in the current process. These resources and this expertise could be usefully harnessed in a more focused way toward test cases for unconscionable conduct and other assistance for small businesses, with a view to encouraging development in the law and a sound evidential basis for policy debate going forward.

This recognises that access to justice for small businesses subject to unconscionable conduct is as important as access to justice in other contexts. It would also assist in promoting worthy *pro bono* legal advice and assistance to such claimants from community legal centres, law firms, and the bar, as part of the legal profession's continuing dedication to *pro bono* work in both commercial and non-commercial matters. *Pro bono* advice and assistance should be integrated, to the extent possible, with governmental policy on small business assistance, consumer advocacy and *pro bono* services.

Further, efforts to improve both research and advocacy will help businesses deal with compliance issues. Given the changes that are being made to the law, including the introduction of civil penalties for unconscionable conduct, the more resources that can be allocated to generating practical examples of unconscionable conduct and educating stakeholders about the nature of the TPA and the Franchising Code, the better will businesses be able to ensure they comply with the amended laws.

## Findings

- 4.1 The issues connected with 'good faith' relevantly apply to the panel's work by virtue of their relationship with statutory unconscionable conduct and the five franchising behaviours (as discussed in Chapters 2 and 3).
- 4.2 The existence of the legal frameworks of the TPA and Franchising Code are important regulatory measures for fostering good business conduct. However, not all business disputes will fall within these frameworks, and it is not necessarily the function of the ACCC to arbitrate every commercial dispute, even where contraventions of the TPA are alleged.
- 4.3 Australian governments, and particularly the States and Territories, should consider whether there are any means whereby early intervention dispute resolution services for small business might be improved and harmonised across jurisdictions as part of existing or proposed reviews.
  - The issue of attribution of legal costs should form part of any examination of the effectiveness of dispute resolution mechanisms.

## Findings (continued)

- 4.4 There should be more research (particularly empirical research) carried out concerning the interests of small business, particularly with respect to the effectiveness of the legal frameworks of the TPA and Franchising Code in protecting these interests. Such research is necessary in order to inform an evidence-based platform for review.
- Consequently, there is scope to improve advocacy and research, including empirical research, with respect to small business interests, including through the use of the *pro bono* resources of the legal profession and the expansion of existing processes considering consumer research and advocacy.
  - The impact of the changes the Government has already announced concerning unconscionable conduct and the Franchising Code, and any changes arising out of this report, should be a particular focus of this research framework. A period of three to five years would provide sufficient time to evaluate evidence of the effectiveness of these changes.
  - The issue of disclosure, particularly in the light of the panel's findings on disclosure in Chapter 3, should also form part of this research framework.

## CONCLUSION

The panel's terms of reference focus on consideration of two unconscionable conduct proposals and five franchising behaviours. However, the panel has also had regard to the place of this process in the broader context of the fair trading debate, with the attendant interest of a wide variety of small business stakeholders and others that is evident in the public submissions, and has taken a somewhat expansive view of its task under the terms of reference. There are no easy answers to the issues raised by stakeholders, as the history of the debate shows, and the panel has endeavoured to ensure that its suggested answers will be meaningful and sensible improvements to the current state of the law.

In terms of unconscionable conduct, the panel considers that an interpretive statement of principles, accompanied by enhanced national guidance by the regulators, will go a long way to addressing business certainty, stakeholder understanding and community confidence in statutory unconscionable conduct. In terms of franchising, the panel's view is that the range of measures it has recommended will encourage greater understanding among franchisees and prospective franchisees of the nature of the business model they are part of, and foster improvements in franchisor attitudes to the concerns of franchisees.

As mentioned at the beginning of this report, in the light of the ongoing debate over fair trading and the scope of protection that should be afforded to small business, it may be thought that the work of this panel cannot achieve any sort of finality. Trade practices

regulatory debate and innovation, as then Justice French noted extracurially, keeps on going but may at times curve in upon itself.

The panel also wants, having made its substantive recommendations, to convey a need for measured reform, consolidation in practice, and continuous improvement and review based on evidence. The introduction of the ACL will shift the trade practices landscape dramatically, including the changes to the unconscionable conduct provisions. Enhancements to the Franchising Code will mark a significant shift in franchising regulation.

It is appropriate that all stakeholders – business, consumer, legal and political – take the time to assess the impact of this changing landscape and reflect on the purposes of the legal frameworks and the significant distance the law has travelled since the TPA was introduced in 1974.

It is timely, then, to embark on a process of taking stock. For this reason it is important that tools for research and advocacy, as discussed in this chapter, be developed to inform the analysis of the state of the law. The panel hopes and believes that the package of measures it has recommended will prove a valuable assistance to the community in supporting the changes that are taking effect, observing their impact, and evaluating the effectiveness of the legal frameworks in three to five years.

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## APPENDIX A CONSULTATION PROCESS

In recommending the inquiry process carried out by the panel, the Senate Economics Committee flagged that the process should 'engage industry participants from the retail tenancy and franchising sectors (among others) and the ACCC'.<sup>260</sup> The panel's terms of reference also refer to the importance of engaging these stakeholders, and small business organisations generally. It is in this context that the panel undertook its task.

In the first instance, the report has been informed by the previous reviews of franchising and unconscionable conduct that led to the panel's establishment. These include the 2008 reports of the Senate Economics Committee on *'the need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the TPA'*, and of the Parliamentary Joint Committee on Corporations and Financial Services *Opportunity not opportunism: improving conduct in Australian franchising*.

The panel has had regard to key submissions and evidence provided in the course of those two inquiries. Further, in preparing its response to the Joint Committee report, on 21 June 2009 the Government released an options paper to canvass stakeholder views on the Committee's recommendations. The panel has been made familiar with the outcomes of that consultation process.

The panel has also considered the reports and associated submissions and evidence of the April 2008 report to the former Western Australian Minister for Small Business *Inquiry into the operation of franchise businesses in Western Australia*, and the May 2008 inquiry of the South Australian Parliament's Economic and Finance Committee on *Franchises*.

On 27 November 2009, in announcing the establishment of the panel, the Government also released an issues paper prepared by Treasury to canvass stakeholder views of the proposals on unconscionable conduct discussed in the Senate Economics Committee report. The issues paper was drawn to the attention of key stakeholders in the franchising, retail tenancy, business and academic sectors. It was also circulated to Commonwealth, state and territory governmental agencies dealing with consumer protection, small business and retail tenancy issues. Fifty submissions were received in response to the issues paper, which provided the panel with a broad range of views about the proposals under consideration.

The panel, both directly and through the departmental secretariats, has benefited from the assistance of the ACCC and ASIC. In particular, the panel met with ACCC senior staff via videoconference to discuss the proposals in the terms of reference and to obtain a regulatory view of the problems the proposals were designed to address.

Further, on 21 January 2010 the ACCC facilitated a meeting with the panel and the ACCC's Franchising Consultative Committee, chaired by ACCC Deputy Chair Dr Michael Schaper.

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260 Pages 38-9 of the Committee's report.

This Committee is a multi-stakeholder body with a broad membership drawn from franchisee and franchisor representatives, together with academic and legal experts in the field. Details of the Committee are available on the ACCC website, [www.accc.gov.au](http://www.accc.gov.au). The meeting with the Committee provided an insight into the views of key stakeholders on the nature and prevalence of the five behaviours in the panel's terms of reference.

### List of submissions in response to the issues paper

Treasury received fifty submissions in response to the unconscionable conduct issues paper. Of these, 36 are public submissions and are available on the Treasury website, [www.treasury.gov.au](http://www.treasury.gov.au). The provisions appear below in chronological order, except where submissions were provided by mail and therefore incorporated into the list at a later date. Where a submission is confidential, the name of the stakeholder does not appear. Additionally, the panel has kept the submissions of government agencies in confidence. Where a stakeholder's name has been abbreviated in the body of this report, its abbreviation is noted here in brackets following the name.

Submission number	Stakeholder	Date received
1	Rod White, Chief Operations Officer, Yong Real Estate	3/12/09
2	Carol O'Donnell	8/12/09
3	David Wright, University of Adelaide Law School	8/12/09
4	Newsagents Association of NSW & ACT and the Queensland Newsagents Federation (NANA/QNF)	16/12/09
5	Competitive Foods Australia	16/12/09
6	Confidential	16/12/09
7	Confidential	17/12/09
8	Confidential	17/12/09
9	Australian Institute of Credit Management	17/12/09
10	Associate Professor Frank Zumbo, Australian School of Business, University of NSW	17/12/09
11	Queensland Law Society	18/12/09
12	Lottery Agents Association of Victoria	18/12/09
13	Shopping Centre Council of Australia (SCCA)	18/12/09
14	Retail Traders Association of Western Australia (RTAWA)	18/12/09



<b>Submission number</b>	<b>Stakeholder</b>	<b>Date received</b>
15	Motor Trades Association of Australia (MTAA)	18/12/09
16	Professors Sharon Christensen and Bill Duncan, Faculty of Law, Queensland University of Technology	18/12/09
17	Franchise Council of Australia	18/12/09
18	National Association of Retail Grocers of Australia (NARGA)	18/12/09
19	Confidential	18/12/09
20	Freehills	18/12/09
21	Association of Consulting Engineers Australia	18/12/09
22	Speed and Stracey (commercial lawyers)	18/12/09
23	Confidential	18/12/09
24	Financial Planning Association of Australia	18/12/09
25	Confidential	18/12/09
26	Confidential	18/12/09
27	Consumer Action Law Centre	21/12/09
28	Victorian Automobile Chamber of Commerce (VACC)	21/12/09
29	Insurance Council of Australia	21/12/09
30	Abacus	21/12/09
31	Insurance Australia Group (IAG)	21/12/09
32	The Pharmacy Guild of Australia	21/12/09
33	Council of Small Business of Australia (COSBOA)	21/12/09
34	Australian Newsagents' Federation (ANF)	21/12/09
35	Madeleine Kingston	21/12/09
36	Post Office Agents Association Limited	22/12/09
37	Australian Finance Conference	22/12/09

Submission number	Stakeholder	Date received
38	Confidential	22/12/09
39	GE Capital	22/12/09
40	Trade Practices Committee, Law Council of Australia (Law Council)	23/12/09
41	State Retailers Association of SA	15/12/09 (by mail)
42	Motor Trades Association of Queensland	18/12/09 (by mail)
43	National Independent Retailers Association	14/01/10
44	Mr Michael Redfern, Consultant, Russell Kennedy	18/01/10
45	Government agency	
46	Government agency	
47	Government agency	
48	Government agency	
49	Government agency	
50	Government agency	

## APPENDIX B RELEVANT CASE LAW ON UNCONSCIONABLE CONDUCT

Chapter 1 of this report discusses some of the key cases which set the context for the law on unconscionable conduct, both within the meaning of the unwritten law and under the provisions of the TPA. This appendix is intended to enhance that discussion with further extracts from the relevant case law. Further detail is also available in the Treasury issues paper, *The nature and application of unconscionable conduct regulation*.

### Origins

In the 1956 case of *Blomley v Ryan*, the High Court articulated the principles on which relief would be granted for unconscionable conduct. Justice Kitto considered that relief would be granted where:

one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands.<sup>261</sup>

In the same case, Justice Fullagar noted that the range of circumstances that would be sufficient to attract relief of this kind was ‘of great variety and can hardly be satisfactorily classified’.<sup>262</sup>

These principles were picked up in the landmark 1983 case of *Commercial Bank of Australia Ltd v Amadio*. Justice Mason referred to the circumstances discussed by Justices Kitto and Fullagar, and stated that:

[i]t is not to be thought that relief will be granted only in the particular situations mentioned by their Honours. It is made plain enough, especially by Fullagar J., that the situations mentioned are no more than particular exemplifications of an underlying general principle which may be invoked whenever one party by reason of some condition of circumstance is placed at a special disadvantage vis-a-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created.<sup>263</sup>

Justice Mason articulated the effect of unconscionable conduct as:

the class of case in which a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage. ...

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261 *Blomley v Ryan* (1956) 99 CLR 362 at 415.

262 *ibid* at 405.

263 (1983) 151 CLR 447 at 462.

Relief on the ground of unconscionable conduct will be granted when unconscientious advantage is taken of an innocent party whose will is overborne so that it is not independent and voluntary, just as it will be granted when such advantage is taken of an innocent party who, though not deprived of an independent and voluntary will, is unable to make a worthwhile judgment as to what is in his best interest.<sup>264</sup>

Similarly, in *Amadio* Justice Deane held that relief for unconscionable conduct might be granted in:

circumstances in which (i) a party to a transaction was under a special disability in dealing with the other party with the consequence that there was an absence of any reasonable degree of equality between them and (ii) that disability was sufficiently evident to the stronger party to make it prima facie unfair or “unconscientious” that he procure, or accept, the weaker party’s assent to the impugned transaction in the circumstances in which he procured or accepted it. Where such circumstances are shown to have existed, an onus is cast upon the stronger party to show that the transaction was fair, just and reasonable.<sup>265</sup>

The two cases of *Blomley v Ryan* and *Amadio* set the scene for much of the development that was to follow. Along the way, the High Court has also made other important statements about unconscionable conduct, the implications of which are still being worked through in the courts, even in judgments being handed down during the course of drafting this report.<sup>266</sup>

Also in 1983, in *Legione v Hateley*, Justices Mason and Deane expressed the view that:

the fundamental principle according to which equity acts [is] that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct’.<sup>267</sup>

### Unconscionable conduct as a defined principle

Nevertheless, this principle has not been treated as a free-standing right, allowing judicial intervention wherever the exercise of legal rights produces what a particular judge thinks is an unfair result. For example, in the 2003 case of *Tanwar Enterprises Pty Ltd v Cauchi*, the High Court resisted the:

false notions that (i) there is a distinct cause of action, akin to an equitable tort, wherever a plaintiff points to conduct which merits the epithet “unconscionable”; and (ii) there is an equitable defence to the assertion of any legal right, whether by action to

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264 *ibid.*, at 461. Mason J noted that the situation where the will of the innocent party is not independent because it is overborne is a case of undue influence. However, the two doctrines are not mutually exclusive and relief on the basis of unconscionable conduct may be available in circumstances characterised by undue influence.

265 *ibid.*, at 474.

266 See, for example, *Tenth Vandy Pty Ltd v Natwest Markets Australia Pty Ltd* [2010] VSC 2.

267 (1983) 152 CLR 406 at 444.

recover a debt or damages in tort or for breach of contract, where in the circumstances it has become unconscionable for the plaintiff to rely on that legal right.<sup>268</sup>

Rather, decisions about unconscionable conduct are mediated through clearly defined doctrines of unconscionable conduct under the judge-made law. This principles-based approach to the law of unconscionable conduct has been explained by NSW Chief Justice James Spigelman in *Attorney General of NSW v World Best Holdings Ltd*:

Unconscionability is a well-established but narrow principle in equitable doctrine. It has been applied over the centuries with considerable restraint and in a manner which is consistent with the maintenance of the basic principles of freedom of contract. It is not a principle of what 'fairness' or 'justice' or 'good conscience' requires in the particular circumstances of the case. As Deane J put it in *Muschinski v Dodds* (1985) 160 CLR 583 at 616:

"... [P]roprietary rights fall to be governed by principles of law and not by some mix of judicial discretion, ... subjective views about which party 'ought to win' ... and 'the formless void of individual moral opinion' ... Long before Lord Seldon's anachronism identifying the Chancellor's foot as the measure of Chancery relief, undefined notions of 'justice' and what was 'fair' had given way in the law of equity to the rule of ordered principle which is of the essence of any coherent system of rational law. The mere fact that it would be unjust or unfair in a situation of discord for an owner of a legal estate to assert his ownership against another provides, of itself, no mandate for a judicial declaration that the ownership in whole or in part lies, in equity, in that other..." ...

The Ministerial Second Reading speech ... indicates a similar concern to distinguish what is unconscionable from what is merely unfair or unjust. Even if the concept of unconscionability in s62B of the *Retail Leases Act* is not confined by equitable doctrine, as the decisions under s51AC of the *Trade Practices Act* suggest, restraint in decision-making remains appropriate. Unconscionability is a concept which requires a high level of moral obloquy. If it were to be applied as if it were equivalent to what was 'fair' or 'just', it could transform commercial relationships in a manner which the Minister expressly stated was not the intention of the legislation.<sup>269</sup>

Chief Justice Spigelman's decision concerned provisions of the *Retail Leases Act 1994* (NSW), and illustrates the link between the statutory provisions and the judge-made law of unconscionability. The High Court's most recent pronouncements on unconscionable conduct also contain important pointers on the connection between the statutory and non-statutory law of unconscionable conduct. For example, in the 2003 case of *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd*, Justices Gummow and Hayne said:

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268 *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315 at 325.

269 *Attorney General of NSW v World Best Holdings Ltd* (2005) 63 NSWLR 557 at 583, per Spigelman CJ.

The parties, correctly, accept that the term ‘unconscionable’ is not used in s 51AA in any sense which is at large or reflects an ordinary or natural meaning in general usage. That is plain from the identification in s 51AA of ‘the meaning’ given by ‘the unwritten law, from time to time’. The identification thus made is the principles of law and equity expounded from time to time in decisions respecting the common law of Australia. ...

French J [the Federal Court judge at first instance] also said:

‘The concept of unconscionability is arguably to be found at two levels in the unwritten law. There is a generic level which informs the fundamental principle according to which equity acts. There is the specific level at which the usage of “unconscionability” is limited to particular categories of case. The Explanatory Memorandum [to the Bill for the 1992 Act] suggests that it is the latter sense that was intended – defined by reference to *Blomley v Ryan* and *Commercial Bank of Australia [Ltd] v Amadio*.’

The relevant passage in the Explanatory Memorandum said of s 51AA that it embodied ‘the equitable concept of unconscionable conduct as recognised by the High Court’ in those two cases.

The reference by his Honour to the use in s 51AA of the term “conduct that is unconscionable within the meaning of the unwritten law” as identifying particular categories of case should be accepted as indicating the proper construction of s 51AA. The argument on the present appeal of all parties appeared to proceed on that footing. However, there then arises the question as to which particular manifestations of equity’s concern with unconscientious or unconscionable conduct are reached by s 51AA. The issue is an important one because s 51AA does more than re-enact for application in trade and commerce the general law principles concerned. Contravention of s 51AA attracts particular remedies under the Act which may not otherwise be available and provides, as this case illustrates, for litigation to be instituted and conducted by a public body, the ACCC. ...

The term ‘unconscionable’ is used as a description of various grounds of equitable intervention to refuse enforcement of or to set aside transactions which offend equity and good conscience. The term is used across a broad range of the equity jurisdiction.<sup>270</sup>

In *Tanwar v Cauchi*, five High Court judges all referred back to those comments from the *Berbatis* decision, and joined in describing unconscionable conduct as follows, at least in terms of its non-statutory forms:

The terms ‘unconscientious’ and ‘unconscionable’ are, as was emphasised in *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd*, used across a broad range of the equity jurisdiction. They describe in their various applications the

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270 *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51 at 71-2, citations omitted.

formation and instruction of conscience by reference to well developed principles. Thus, it may be said that breaches of trust and abuses of fiduciary position manifest unconscientious conduct; but whether a particular case amounts to a breach of trust or abuse of fiduciary duty is determined by reference to well developed principles, both specific and flexible in character. It is to those principles that the court has first regard rather than entering into the case at that higher level of abstraction involved in notions of unconscientious conduct in some loose sense where all principles are at large.<sup>271</sup>

### Special disadvantage

*Blomley v Ryan* and *Amadio* both incorporate the notion of one party being at a 'special disadvantage' to the other, and provide examples of the circumstances in which this disadvantage might exist. These examples may be said to characterise a 'constitutional disadvantage'; that is, a disadvantage inherent in the personal characteristics of the party at a special disadvantage. The law has developed since those decisions to recognise that a 'situational disadvantage' may qualify as a special disadvantage for the purposes of the unconscionable conduct law. In *Samton*, the Full Federal Court said of special disadvantage that it:

may be constitutional, deriving from age, illness, poverty, inexperience or lack of education – *Commercial Bank of Australia Ltd v Amadio*. Or it may be situational, deriving from particular features of a relationship between actors in the transaction such as the emotional dependence of one on the other – *Louth v Diprose*; *Bridgewater v Leahy* (1998) 194 CLR 457.

This principle was acknowledged by Chief Justice Gleeson in *Australian Competition and Consumer Commission v CG Berbatis Holdings Ltd*, who said that:

In the present case, French J said that the lessees suffered from a 'situational' as distinct from a 'constitutional' disadvantage, in that it did not stem from any inherent infirmity or weakness or deficiency. That idea was developed somewhat in a joint judgment, to which French J was a party, in *Australian Competition and Consumer Commission v Samton Holdings Pty Ltd*, where it was said that, under the rubric of unconscionable conduct, equity will set aside a contract or disposition resulting from the knowing exploitation by one party of the special disadvantage of another, and then it was said:

'The special disadvantage may be constitutional, deriving from age, illness, poverty, inexperience or lack of education: *Commercial Bank of Australia Ltd v Amadio*. Or it may be situational, deriving from particular features of a relationship between actors in the transaction such as the emotional dependence of one on the other: *Louth v Diprose*; *Bridgewater v Leahy*'.

While, with respect to those who think otherwise, I would not assign the facts of *Bridgewater v Leahy* to such a category, the reference to emotional dependence of the kind illustrated by *Louth v Diprose* as a form of special disadvantage described as

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271 *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315 at 324.



'situational' rather than 'constitutional' is understandable and acceptable, provided that such descriptions do not take on a life of their own, in substitution for the language of the statute, and the content of the law to which it refers. There is a risk that categories, adopted as a convenient method of exposition of an underlying principle, might be misunderstood, and come to supplant the principle. The stream of judicial exposition of principle cannot rise above the source; and there is nothing to suggest that French J intended that it should. A problem is that the words 'situation' and 'disadvantage' have ordinary meanings which, in combination, extend far beyond the bounds of the law referred to in s 51AA; and, it may be added, far beyond the bounds of what was explained to Parliament as the purpose of the section.

One thing is clear, and is illustrated by the decision in *Samton Holdings* itself. A person is not in a position of relevant disadvantage, constitutional, situational, or otherwise, simply because of inequality of bargaining power. Many, perhaps even most, contracts are made between parties of unequal bargaining power, and good conscience does not require parties to contractual negotiations to forfeit their advantages, or neglect their own interests.<sup>272</sup>

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272 (2003) 214 CLR 51 at 63-4.

## **APPENDIX C ACCC ENFORCEMENT OF UNCONSCIONABLE CONDUCT**

A brief account of the ACCC's activity in enforcing statutory unconscionable conduct is extracted here to illustrate the extent and diversity of that activity. This information was compiled by the ACCC and provided to the panel at the panel's request.

### **Section 51AB enforcement**

The ACCC has litigated 18 cases in relation to section 51AB. Of these, six were resolved in fully contested hearings, and the ACCC was successful in five of those matters. Of the remaining 12 matters, ten were settled by consent declarations and the remaining two were settled without declarations. The ACCC has accepted section 87B undertakings in five section 51AB matters where the undertakings were accepted without court proceedings being instituted.

### **Successful litigation**

#### **Collings Construction Co Pty Ltd, Venture Industries Pty Ltd (1996)**

The case was originally instituted by the Trade Practices Commission in the Federal Court in 1993, seeking injunctions and damages for named consumers. The case was transferred to the NSW Supreme Court and heard in 1995, with judgment handed down in 1996. The case related to consumers entering design and construction contracts with Collings on an 'all inclusive' basis, then being passed to Venture for construction, where they would be liable for more costs. Damages in excess of \$1 million was awarded to the seven named families.

#### **CDRC's Financial Network (1998)**

CDRC's Financial Network, a Victorian business, was alleged to have misled vulnerable consumers by way of advertisements nationally in local newspapers advising that cash loans can be obtained utilising a \$5 per minute 1902 live information number. Consent orders were made restraining Cedrick Desmond Collinson or any legal entity with which he is associated from engaging in such conduct in the future.

#### **HRJ Financial Services Pty Ltd (2000)**

The ACCC alleged that HRJ's advertising represented that personal loans were available to callers from the operator of a 1900 phone call, which actually only provided advice on how to secure a loan. The calls to the 1900 number were expensive. The ACCC was concerned that the advertising was aimed at pensioners, bankrupts and people with bad credit. Settlement was negotiated with the liquidator of HRJ that provided for refunds to consumers.

Federal Court consent orders were granted for injunctions against HRJ and the bankrupt directors, Rowland Thomas and Helen Lewis.

#### [Black on White Pty Ltd \(Australian Early Childhood College\) \(2001\)](#)

The ACCC obtained Federal Court orders declaring Black on White Pty Ltd had engaged in unconscionable conduct by signing students up to contracts without disclosing the onerous nature of some contract clauses.

#### [Moore Talk Communication \(2001\)](#)

Unconscionable, misleading and deceptive conduct in the promotion of mobile phone and access plan packages led to consent orders being issued by the Federal Court, Brisbane, and a court enforceable undertaking being provided by Moore Talk.

#### [Inthebigcity.com Pty Ltd \(2001\)](#)

Advertisements appeared in APN Newspapers between July 2000 and April 2001 promoting an employment service offered by inthebigcity.com Pty Ltd, where callers to a 1900 premium rate telephone service (at \$2.48 per minute) would be guaranteed work, and be entitled to discounts on accommodation and removalist costs. There were no guarantees of employment or discounts available. Court orders by consent included injunctions and undertakings providing for payment of refunds to affected consumers and corrective advertising.

#### [Axxess Australia Pty Ltd, Benchmark Sales Pty Ltd \(2002\)](#)

Door to door and telemarketing sales companies 'slammed' consumers (transferred their telephone service without authorisation). The ACCC alleged the companies illegally obtained signatures and verbal authorities from consumers through a range of methods. The companies admitted they had breached the TPA, and undertook to review their trade practices compliance procedures and adopt industry codes of practice. The companies were also ordered to contribute \$60,000 to a fund established by the ACCC to raise awareness of consumer rights concerning phone services, while injunctions restraining the companies from engaging in misleading and deceptive conduct were also issued.

#### [Solutions Software/Acepark \(2002\)](#)

The court found that Robert James Price misled consumers and, in one instance, acted unconscionably in connection with the marketing and sale of horse race betting software in Australia and New Zealand. The court's findings included that, contrary to what purchasers were told, the program was a gambling program (and not an investment program), did not have a strike rate of success of between 70 and 95 per cent, and there were no reasonable grounds for representing that purchasers could expect to earn income or profit using the program.

#### [Free2AiR \(2002\)](#)

The court declared the conduct of Free2AiR to be misleading and deceptive (supplying internet services subject to terms and conditions not disclosed to consumers before they subscribed), unconscionable (threatening to disconnect customers if they questioned the imposition of an administration fee, carrying out unauthorised credit card deductions) and to constitute harassment and coercion (threatening to disconnect, and referring to a debt collection agency). Orders also included injunctions and costs.

#### [Dodo Internet Pty Ltd \(2003\)](#)

The court declared Dodo to have engaged in unconscionable conduct by failing to check the accuracy of dial-in telephone numbers provided to consumers, failing to fairly and properly investigate customer complaints, refusing to deal or negotiate with complainants, and seeking to rely on unlawful exclusion clauses. Orders included requiring Dodo to pay compensation to some consumers, and inform its customers of the findings and injunctions.

#### [Esanda Finance Corporation \(2003\)](#)

Esanda consented to declarations it had acted unconscionably (through debt collectors and tow truck operators) in the repossession of a car, including through agents entering a home by jumping a gate, not stopping re-possession in the face of a physical confrontation, and repeated attendance at consumer's home and work. Esanda was restrained from similar conduct in the future, required to change some processes, and paid compensation to the customer and the ACCC's costs.

#### [Lux Pty Ltd \(2004\)](#)

Unconscionable conduct took place in connection with the door-to-door sale of a \$900 vacuum cleaner to a vulnerable consumer. The court found that the sales agent should have recognised the woman was substantially illiterate, unable to understand commercial matters in any depth, and was unlikely to be able to make a worthwhile judgement about whether the purchase was in her best interests. The court considered the meeting at the woman's home was 'irreconcilable with what was right or reasonable'.

#### [Raymon Keshow \(National Maths Academy\) \(2005\)](#)

A promoter of educational materials was found to have acted unconscionably in dealings with indigenous communities in remote areas, particularly in relation to signing consumers up to automatic deductions. One of the consumers was unemployed, spoke English as a second language, lived in relative poverty and had more than \$10,000 deducted from her bank account without receiving any of the promised materials. She also had little or no experience in business dealings. The court banned Mr Keshow from entering indigenous communities in the Northern Territory to conduct business, and from receiving automatic payments for goods or services without full disclosure of their effect.

#### [The Rana System \(NuEra\) \(2007\)](#)

NuEra Health Pty Ltd and Mr Paul Rana were found to have engaged in unconscionable conduct against highly vulnerable consumers when signing them up to pay for alternative cancer treatments. The conduct was described as 'being of the most reprehensible kind, revealing a cynical and heartless exploitation'.

#### [Craftmatic Australia \(2009\)](#)

The ACCC alleged that Craftmatic had acted unconscionably against senior citizens in the door-to-door sale of beds, by taking advantage of the commercial inexperience of elderly and housebound consumers through high pressure sales tactics. Craftmatic agreed to court declarations and injunctions.

The declarations specified that Craftmatic's method of promotion and sale consisted of steps designed, scripted and conducted to unduly influence potential customers and to create and take advantage of an unequal bargaining position.

The consent orders also identified that Craftmatic's methods were intended to take advantage of certain characteristics of the target market; that is, the perceived politeness, commercial inexperience, health concerns, and susceptibility to high pressure and misleading sales tactics, of older persons in their homes.

### **Litigation settled without declarations**

#### **Domaine Homes (2001)**

The ACCC instituted proceedings against Domaine and several others in relation to Domaine's implementation of the GST in 2000, in particular the promotion of its 'Guaranteed Fixed Price' contracts in 1999 and subsequent charging of additional GST on those contracts. This was a representative action on behalf of seven Domaine customers seeking refunds and compensation, plus injunctions requiring Domaine to refund the remaining customers the GST they had paid.

Domaine provided the court with undertakings (without admitting liability) to refund 260 home buyers a total of approximately \$1.9 million of GST payments plus interest.

#### **Fox Symes & Associates (2005)**

The ACCC alleged that Fox Symes had acted unconscionably in its dealings with some consumers, in particular regarding representations about the effect of a debt agreement on a consumer's credit rating, the amount of fees payable for a service and the nature and effect of documents provided by Fox Symes. The undertaking provided to the court – without admission – included an agreement not to make certain statements about debt agreements, use best endeavours to inform consumers of the ramifications of entering a debt agreement, explain documents, and bring fees to the attention of consumers.

### **Unsuccessful litigation**

#### **Radio Rentals (2005)**

The ACCC alleged that Radio Rentals acted unconscionably in its dealings with an intellectually disabled man, resulting in his entering 15 rental agreements and two loan agreements with Radio Rentals and three rental agreements with another store. The court found that Radio Rentals had not acted unconscionably, but noted that the case highlighted the peculiar vulnerability of persons who are unable to conserve their own interests but who do not put people with whom they deal on notice of their incapacities.

### **Section 87B undertakings**

#### **Lyscard and Family Educational Publishers (1995)**

Both parties gave undertakings concerning unconscionable and misleading and deceptive conduct in relation to Collier Encyclopaedias and false representations that a free gift accompanied purchase. They undertook not to engage in unconscionable, misleading or deceptive conduct in the sale of books in Australia in future, to reimburse consumers, and to

establish a trade practices compliance program (to be monitored with regular reports provided to the Commission).

#### **Acepark (1999)**

Acepark sold a computer software betting or investment program to the public, and had operated under different names. The ACCC's view was that Acepark has contravened sections 51AB, 52, 53(c), 53(d), and 59(1) of the TPA. Acepark undertook to cease legal actions for recovery of payment against various customers and release them from any further claims, to refund payments made by these customers to Acepark, to compensate them for proven losses, and set up a structured complaints handling system.

#### **OneTel (1999)**

OneTel provided undertakings in response to ACCC concerns about their reliance on variation clauses to vary its mobile phone customer contracts in breach of the TPA, including section 51AB. One.Tel undertook to amend its contract, not to vary existing customer contracts, provide refunds, complete a TPA compliance program and sign up to an industry code.

#### **OneTel (1999)**

The ACCC commenced an investigation into complaints about the promotion of One.Tel's 'Switch' product. One.Tel, through its agents, had been promoting this product by means of door-to-door sales since April 2000 and outbound telemarketing since May 2000. The complaints concerned transfers to One.Tel made without the consumer's consent or informed consent.

As a result of its investigations, the ACCC formed the view that One.Tel's agents and those agents' representatives had breached Part IVA and V of the Act and that One.Tel was liable for their conduct. Specifically, the ACCC concluded that between April 2000 and October 2000, the representatives had induced transfers without the consent or informed consent of the consumers concerned.

### **Section 51AC enforcement**

The ACCC has litigated 19 cases in relation to section 51AC. Of these, nine were settled by way of consent declarations that the parties had contravened section 51AC, three were settled without consent declarations, five were determined by the court and two have yet to be determined by the court. Of the five determined by the court, the ACCC was successful in three matters and unsuccessful in two. The ACCC has accepted section 87B undertakings in two section 51AC matters where the undertakings were accepted without court proceedings being instituted.

## Current litigation

### *ACCC v Seal-A-Fridge Pty Ltd*

In July 2008, the ACCC commenced proceedings against Seal-A-Fridge<sup>273</sup>, alleging unconscionable conduct towards its franchisees by effectively withholding consent to the transfer of franchises by: the imposition of terms in the proposed replacement franchise agreements which were significantly more onerous than in the franchise agreements then in use; and unilaterally increasing the fees associated with the national Seal-A-Fridge telephone number contrary to the franchise agreements. It is also alleged that Seal-A-Fridge breached the Franchising Code. The ACCC is seeking a range of orders, including declarations, injunctions and costs. A six day trial concluded in October 2009.

### *ACCC v Allphones Retail Pty Ltd & Ors*

In March 2008, the ACCC instituted proceedings against Allphones<sup>274</sup> in relation to: alleged unconscionable conduct in the form of failing to disclose or pay certain income to franchisees; implementing policies targeting certain classes of franchisees; and threatening or engaging in a pattern of harsh conduct against franchisees. It is also alleged Allphones failed to comply with the Franchising Code and engaged in misleading or deceptive conduct towards franchisees. The hearing is listed to commence on 23 March 2010.

## Successful litigation

### *Simply No-Knead (Franchising) Pty Ltd (2000)*

It was alleged that Simply No-Knead had engaged in unconscionable conduct in its behaviour towards franchisees. Simply No-Knead had threatened to withhold obligatory disclosure documents unless each franchisee gave written consent to renew the agreement, and also competed directly with the franchisees in a way that was calculated to harm their business.

### *Leelee Pty Ltd (2000)*

The ACCC brought action against a lessor of food stalls in an international food hall in Adelaide. The court declared, by consent, that Leelee engaged in unconscionable conduct by:

- consenting to, or giving approval for, another tenant to infringe on the exclusive menu entitlements conferred by Leelee on one of its tenants; and
- specifying the price at which the tenant sold its dishes in a manner which unfairly discriminated against, or inhibited, the tenant's ability to determine the prices at which its dishes were sold in competition with another tenant.

### *Daewoo Australia Pty Ltd (2002)*

The court declared that Daewoo Australia engaged in unconscionable and misleading conduct in connection with the 1998 appointment of Porter Crane Imports Pty Ltd as its Queensland dealer of excavators and wheel loaders. The court found that Daewoo Australia, by entering into the agreement with Porter Crane having failed to disclose its actual

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273 ACCC, 'ACCC institutes proceedings against Seal-A-Fridge Pty Ltd' (media release, 22 July 2008).

274 ACCC, 'ACCC takes class action on behalf of Allphones franchisees' (media release, 18 August 2009).



intentions, engaged in misleading and unconscionable conduct in breach of sections 52 and 51AC of the TPA.

#### [Suffolke Parke Pty Ltd \(2002\)](#)

Suffolke Parke leased out premises to D&J Shannon Pty Ltd, a franchisee. Part of the leased premises was a separate shop, which Shannon had been permitted to sublet on previous occasions. After disputes between Suffolke Parke and Shannon, Suffolke Park refused to allow Shannon to sublet the shop. This was allegedly in reprisal for complaints arising from actions taken by Shannon and other franchisees concerning the conduct of the director of Suffolke Parke as a director of the master franchisee for South Australia.

The court issued consent orders that the franchisor, Suffolke Parke Pty Ltd had acted unconscionably toward its tenant.

#### [Cheap as Chips Pty Ltd \(2003\)](#)

Franchisees alleged that Cheap as Chips (CAC) terminated franchise agreements and imposed new and unreasonable conditions and threatened to suspend franchisees from work or cancel franchises when imposing these conditions. It was also alleged that CAC contravened the Franchising Code in inducing a franchisee not to associate with other franchisees, and not following the dispute resolution or termination procedures set out in the Code.

The court declared, by consent, that CAC engaged in unconscionable conduct in relation to a number of forms of conduct, including threatening to terminate franchisees rather than negotiating disputes.

#### [Avanti Investments Pty Ltd \(2003\)](#)

The ACCC alleged that Avanti Investments engaged in unconscionable conduct when it entered into agreements with the farmers to lease land, and over time made the farmers sign new agreements that significantly reduced the amount of water available, whilst representing to the farmers that the new agreements were the same as the original agreements. The ACCC pursued this case because the farmers appeared to have been exploited by Avanti due to their lack of education, English language skills and inexperience in commercial dealings.

The court declared that Avanti had engaged in unconscionable conduct and made various misrepresentations to the lessees in contravention of the TPA.

#### [Arnolds Ribs and Pizza \(Australia\) Pty Ltd \(2004\)](#)

The ACCC alleged that the Arnolds Ribs and Pizza franchisor had engaged in misleading, deceptive or unconscionable conduct in promotion of its franchised fast food business in breach of sections 52, 59(2) and 51AC of the Act.

The court declared, by consent, that the Arnolds franchisor had engaged in unconscionable conduct.

#### [Australian Industries Group Pty Ltd \(2005\)](#)

The ACCC alleged that AIG: published an advertisement for employment, when the position related to a business opportunity; breached the Franchising Code in relation to the 'licence agreements' it made with installers and the dealership; made false representations to prospective licensees about the potential profitability of the business; and acted unconscionably towards the installers.

The court declared by consent that AIG had engaged in unconscionable conduct, breached the Franchising Code and made false representations about the profitability of the businesses in breach of the TPA.

#### [Brambles Australia Ltd \(Cleanaway\) \(2006\)](#)

The ACCC alleged that Cleanaway engaged in misleading, deceptive and unconscionable conduct in relation to the circumstances in which it entered into contracts with customers.

The court declared that Cleanaway engaged in unconscionable conduct in contravention of section 51AC of the TPA in that the conduct occurred in circumstances where unfair tactics were used, and where Cleanaway did not act in good faith.

#### [Dataline.net.au Pty Ltd \(2006\)](#)

The Federal Court declared that Dataline.net.au Pty Ltd engaged in unconscionable and misleading and deceptive conduct in connection with the supply of internet related services to small businesses and consumers throughout Australia. The court held that Dataline had engaged in unconscionable conduct in not permitting small ISPs to obtain legal advice before signing their contracts with Dataline, and threatening the ISPs with disconnection if they did not agree to sign further agreements with Dataline.

#### [Dukemaster Pty Ltd \(2009\)](#)

The ACCC alleged Dukemaster, a landlord of retail outlets engaged in unconscionable conduct in breach of the TPA by taking unfair advantage of its stronger bargaining position, exerting undue pressure and using unfair tactics against four tenants in connection with their leases. The court found that Dukemaster had engaged in unconscionable conduct.

#### [Australialink Pty Ltd \(2009\)](#)

The ACCC alleged that Australialink engaged in misleading or deceptive conduct and unconscionable conduct, in breach of sections 52 and 51AC of the TPA, in relation to false billing for an online business directory.

The court declared that Australialink acted unconscionably towards businesses by intentionally misrepresenting that it had instituted, or was in the process of instituting, court proceedings against those businesses that had been invoiced for the directory listing but had not paid.

#### **Litigation settled without declarations**

##### [Moore Talk Communications Pty Ltd \(2001\)](#)

Moore Talk Communications contacted consumers and asked them to participate in a survey. When the survey was completed the consumers were advised that they would be

entered into a draw to win a free mobile phone. The consumers were then advised that they had been successful, and a fax was sent detailing the specifications of the phone, the free inclusions and listing a number of access plans. Moore Talk failed to fax the reverse side of the application, which contained the terms and conditions, and a condition of receiving the phone was to join an access plan.

The ACCC was of the view that this conduct contravened sections 52, 53(g), 51AB and 51AC of the TPA. The court granted a number of injunctions by consent against the company.

#### [Kwik Fix International Pty Ltd \(2003\)](#)

This matter involved allegations of unconscionable conduct, misleading or deceptive conduct, false or misleading representations and contraventions of an industry code with respect to the sale of a franchise and the course of the business relationship thereafter. The matter was settled on the basis of no declarations against Kwik Fix but the company would provide limited relief to the complainant.

#### [Westfield Shopping Centre Management Co. \(Qld\) Pty Limited \(2004\)](#)

The ACCC began proceedings against Westfield alleging misleading or deceptive conduct and unconscionable conduct in breach of the TPA.

In particular, the ACCC alleged that Westfield acted unconscionably by making it a condition of the settlement of private litigation that former tenants would sign a deed of release containing a clause releasing Westfield from liability. Amongst other things, the clause required the former tenants not to commence or continue any action (including any administrative or governmental investigation against Westfield) in connection with the subject matter of their private litigation.

Westfield provided an undertaking to the Federal Court addressing the ACCC's concerns that a condition sought through its solicitors from the former tenants during settlement of private litigation between Westfield and those tenants may have contravened section 51AC.

#### **Unsuccessful litigation**

##### [Oceana Commercial Pty Ltd & Ors \(including the Commonwealth Bank of Australia\) \(2004\)](#)

This case involved a number of allegations of misleading and deceptive conduct related to the marketing of investment properties on the Gold Coast, made against Oceana Commercial Pty Ltd and several other respondents including subsidiary companies and company owners. One aspect of this case was the allegation that the Commonwealth Bank had acted unconscionably in that it agreed to loans despite being aware that the fair market values of units being sold were far less than the values being touted by the sales staff and the actual sale prices.

The court found that the Bank had not acted contrary to good conscience in failing to warn the complainants that they had contracted to purchase a unit at a price far above its market value.

#### 4WD Systems Australia Pty Ltd (2005)

The ACCC alleged that 4WD Systems engaged in unconscionable conduct in refusing to deliver stock ordered by franchisees, supplying poor quality or damaged stock to franchisees, refusing to provide refunds for these products, refusing to provide copies of the franchise agreement, refusing to provide disclosure documents, refusing to negotiate with franchisees in relation to the franchise agreements and competing directly with the franchisee.

The court held that this conduct was not unconscionable, even if all the allegations are considered cumulatively. The court held that section 51AC is not a general 'catch all' provision, and what is necessary is to show that the conduct was so unacceptable that it could properly be described as unconscionable.

#### **Section 87B undertakings**

##### Scotty's Premium Pet Foods Franchising Pty Ltd (2006)

The ACCC was concerned with Scotty's behaviour in issuing notices of breach to franchisees and threatening franchisees with termination. This behaviour may fall under the factors found in paragraphs 51AC(3)(a), (b) and (g).

##### Medibank Private Limited (2001)

The ACCC was concerned with Medibank's behaviour in imposing a unilateral variation clause into a Hospital Purchaser Provider Agreement. The ACCC was also concerned with Medibank's behaviour in delaying negotiations. Behaviour may fall under the factors found in paragraphs 51AC(3)(a), (d), (f), (i), (j) and (k).

## APPENDIX D PREVIOUS REVIEWS CONCERNING UNCONSCIONABLE CONDUCT AND FRANCHISING REGULATION

As discussed in Chapter 1, both unconscionable conduct regulation and the franchising sector have been the subject of a number of reviews, in particular since the TPA was introduced in 1974.<sup>275</sup>

### Unconscionable conduct

In 1976 the Trade Practices Review Committee (or Swanson Committee), established by the Fraser Government, inquired into whether the TPA was achieving its purpose in developing and maintaining a free and fair market. The Swanson Committee considered there was no basis for the introduction of a prohibition of unfair conduct, but recommended that unconscionable conduct or practices in trade or commerce might be prohibited, to address the disparity in bargaining power between buyers and sellers.<sup>276</sup>

However, in 1979 the Trade Practices Consultative Committee (Blunt Committee) reported that such a provision would conflict with the competition provisions in Part IV of the TPA.<sup>277</sup>

In 1984 a green paper entitled *Trade Practices Act: Proposals for change* – prepared by the Attorney-General, the Hon Gareth Evans MP QC, the Minister for Employment and Industrial Relations, the Hon Ralph Willis MP, and the Minister for Home Affairs and the Environment, the Hon Barry Cohen MP – discussed a proposal for a prohibition of unconscionable conduct in the TPA, and provided a draft of what is now section 51AB of the TPA. That provision was introduced as section 52A, in substantially reduced form, in 1986.<sup>278</sup>

In its 1989 report on *Mergers, Takeovers and Monopolies: Profiting from Competition?*, the House of Representative Standing Committee on Legal and Constitutional Affairs considered the possibility of extending section 52A to business transactions, but noted there was significant opposition to this proposal.<sup>279</sup> However, the following year the House of Representatives Standing Committee on Industry, Science and Technology (the Beddall Committee) recommended such an extension in its report *Small Business in Australia: Challenges, Problems and Opportunities*.<sup>280</sup>

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275 Much of this material is drawn from Sharpe, M and Parker, C, 'A bang or a whimper? The impact of ACCC unconscionable conduct enforcement' (2007) 15 *Trade Practices Law Journal* 139.

276 Trade Practices Review Committee, *Report to the Minister for Business and Consumer Affairs*, 20 August 1976. See Healey, D, 'Unconscionable Conduct in Commercial Dealings' (1993) 1 *Trade Practices Law Journal* 169 at 169-70 for a discussion of the report.

277 Trade Practices Consultative Committee, *Small Business and the Trade Practices Act* (1979). See Sharpe and Parker (2007), page 140.

278 Sharpe and Parker (2007), page 140.

279 *ibid.*, page 141.

280 *ibid.*

This recommendation was echoed in the Australian Labor Party's 1991 *Special Caucus Committee of Inquiry into Aspects of the Australian Petroleum Industry*.<sup>281</sup> The Trade Practices Commission made a similar recommendation, also in 1991.<sup>282</sup> However, the contrary view was expressed in December 1991 by the Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee) in *Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls*, which warned that the provision could introduce significant uncertainty into business transactions.

The following year section 51AA was introduced into the TPA, which was not restricted to consumer transactions like section 51AB, and so applied to commercial transactions more generally, but was still intended to have the same scope as the equitable doctrines of unconscionable conduct.

The next significant inquiry in this area was the work of the House of Representatives Standing Committee on Industry, Science and Technology (Reid Committee) in 1997. As discussed in Chapter 1, the report of the Reid Committee led to the introduction of section 51AC of the TPA and the Franchising Code of Conduct.

The Reid Committee suggested that many small businesses were vulnerable to exploitation, particularly with respect to franchising, retail tenancy, the misuse of market power and in connection with small business finance. It recommended a series of measures designed to address these issues, but also to introduce generic legislation addressing 'unfairness' in business relationships. In particular, the Reid Committee recommended a provision, replacing the provisions of Part IVA of the TPA, prohibiting corporations, in trade or commerce, from engaging 'in conduct that is, in all the circumstances, unfair'.<sup>283</sup>

The previous Government's response to the Reid Committee's report, announced on 30 September 1997, did not endorse absolutely the recommendation for a prohibition of 'unfair' conduct. Rather, it committed to a new provision in the TPA 'that will give small business genuine access to protection against unconscionable conduct'.<sup>284</sup> It also agreed to the introduction of a mandatory code of conduct for franchising.

Section 51AC and Part IVB of the TPA (which creates the legislative framework for prescribing mandatory industry codes) were introduced in 1998.

Since the Reid Committee, there have been three significant reviews into unconscionable conduct. The 2003 report of the Committee of Inquiry for the Review of the Trade Practices Act (chaired by Sir Daryl Dawson AC KBE CB), *Review of the Competition Provisions of the Trade Practices Act*, recommended that guidelines be provided on the operation of Part IVA. In 2004 the Senate Economics Committee recommended various changes to section 51AC in

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281 *ibid.*

282 Australian Trade Practices Commission, *Unconscionable Conduct and the Trade Practices Act: Possible Extension to Cover Commercial Transactions* (July 1991).

283 Standing Committee on Industry, Science and Resources, House of Representatives, Australian Parliament, *Finding a Balance: Towards Fair Trading in Australia* (1997), page xxvi.

284 Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, page 8767 (the Hon Peter Reith MP, Minister for Workplace Relations and Small Business).

its report on *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business*. And in 2008, the same Committee reported on *The need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974*, which gave rise to this current process.

## Franchising

A number of the reviews and inquiries mentioned above also dealt with problems associated with the franchise relationship. For instance, the 1976 Swanson Committee considered the issue of termination of franchise agreements and expressed concern at the nature of the transaction.<sup>285</sup> The 1979 Blunt Committee's recommendation of a general law regulating the franchising relationship resulted in the enactment of legislative arrangements for petroleum retail franchises 1980.<sup>286</sup>

The Beddall Committee in 1990 examined franchising in some detail. Its report discussed<sup>287</sup> a previous attempt during the 1980s by the Ministerial Council for Companies and Securities to create a Franchise Agreements Act. The Ministerial Council ultimately abandoned the project on the basis that the existing generic law already provided adequate protection for parties to franchise agreements. The Beddall Committee considered that problems in the franchising sector would be best addressed by specific franchising legislation, and recommended<sup>288</sup> that the Ministerial Council and the Commonwealth Attorney-General re-examine the case for specific franchising legislation.

Also in 1990, the Commonwealth Government established a Franchising Task Force, which in 1993 published a voluntary Franchising Code of Practice, which applied to all members of the Franchise Council of Australia. In 1994 this voluntary Code was reviewed – at the request of then Minister for Small Business, Customs and Construction, Senator the Hon Chris Schacht – by Mr Robert Gardini. The Gardini report indicated that the voluntary code had not achieved sufficient coverage of the sector and that a mandatory code may be appropriate.

The Reid Committee also examined franchising, and recommended the compulsory registration of franchisors, which would then be required to comply with the Code of Practice.<sup>289</sup>

When the mandatory Franchising Code became law in 1998, the Government established a Franchising Policy Council to monitor its implementation.<sup>290</sup> A review of the effectiveness of the Franchising Code in 2000 supported some minor changes to the Code as well as measures to improve awareness in the sector.

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285 See Spencer, EC, *The Regulation of the Franchise Relationship in Australia: A Contractual Analysis* (PhD thesis, Bond University, 2007), pages 43-7.

286 The *Petroleum Retail Marketing Franchise Act 1980* and the *Petroleum Retail Marketing Sites Act 1980* were repealed in 2006 and replaced with the Oilcode, a mandatory code of conduct prescribed under Part IVB of the TPA.

287 On pages 227-32.

288 On pages 234-5.

289 Recommendation 3.3, on page 120.

290 Spencer (2007), pages 54-7.



In 2006, the previous Government commissioned a review of the disclosure provisions of the Franchising Code, by a committee led by Mr Graeme Matthews. In response to the Matthews Committee report, the Government introduced amendments to the Franchising Code, which took effect on 1 March 2008.<sup>291</sup>

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291 For further information see the website of the Department of Innovation, Industry, Science and Research, <http://www.innovation.gov.au/Section/SmallBusiness/Pages/FranchisingCodeofConduct.aspx> at 14 January 2010.