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Dear Sir

Submission: Resolution of Small Business Disputes Options Paper: May 2011

My perspective is based on my experience as a commercial lawyer advising small businesses, retail landlords, franchisees and franchisors for nearly 20 years to 2000, a trained franchise mediator and an academic researching and teaching franchising law since 2002.

My research includes franchisor insolvency, stakeholder participation in government inquiries, resolution of franchise disputes and real and intellectual property rights within franchise networks and research into the capacity of the common law of contract, and the statute consumer protection law to protect franchisees whose franchisor goes into administration or becomes insolvent.

I have been a member of the ACCC's Franchise Consultative Committee since 2010.

I note that the DIISR commissioned Summary report of June 2010 specifically omitted disputes with overseas businesses or in regard to franchising or retail tenancy. It should be noted that the Franchising Code of Conduct does not apply to all franchise disputes. Accordingly, any proposal for resolution of small business disputes should include franchising. It should also include retail lease disputes as not all parties occupying retail premises, or all occupancy models, are protected under state retail tenancies legislation.

I will make some general observations and then address some of the specific questions posed in relation to each of Options 1 to 4.

Problems surrounding resolution of franchise disputes in Australia

1. **Scope of the Franchising Code of Conduct**[1] ('the Code') The dispute resolution procedure that the Code mandates for disputes between parties to franchise agreements is mediation. See limitations under my response to Option 2.
2. **Lack of accurate data** about franchise disputes because there is no central clearing house for ex ante or ex post information about franchise disputes.
3. **Due diligence impeded.** Because of the lack of data and level of confidentiality surrounding mediation meaningful due diligence cannot be conducted by prospective franchisees on franchise mediations.
4. **Confidentiality clauses 'gag' franchisees**. Franchisees that have been involved in mediation should be a good source of information for prospective franchisees on a one to one basis, but franchisees that have been involved in mediation are often 'gagged' by confidentiality clauses. This problem was noted to the South Australian franchsie inquiry in 2008 where retailer representatives wrote that '[i]t is not in the best interests of good business that people can put in place confidentiality clauses in contracts [for example contracts to resolve mediated disputes] … and then proceed to do the wrong thing'.[2]
5. **Confidentiality masks the number of disputes**. According to the ACCC, 'between 1 October 1998 and 21 August 2008, the O[ffice of the] M[ediation] A[dviser] . . . appointed a mediator in 940 matters and achieved an average settlement rate of 75 to 76 per cent'.[3] Elizabeth Spencer pointed out that 'What you have is a high settlement rate of 72 per cent for mediation. The problem is that there were 300 of those, but there were another 770 inquiries and noone knows what happened to them. . . . Somebody had a big enough problem to call the Office of the [Franchise] Mediation Adviser and ask for help, and we have no idea what happened to them. Franchisors know what happened in the dispute. They can go on and use that information with their other franchisees. But individual franchisees, because of the confidentiality of the process, do not share that information.[4] Clause 30A(5)(a) requires that the Mediation Adviser ('MA') be notified of terminated mediations. The MA publishes raw number of mediators appointed to disputes by the OFMA and raw number of disputes resolved at mediation but there is no published data on any specific individual mediated dispute. Franchisors are required to disclose litigation[5] they are involved in but not mediated disputes.
6. Ethical issues about confidentiality in Alternative Dispute Resolution (ADR) conflict with "sunshine laws" and other open government policies and demonstrate the competing values that inform ADR (C Menkel-Meadows).
7. The **ACCC has jurisdiction** to be involved only in disputes where there is a breach of the *Competition and Consumer Act 2010* or a breach of the Code. It does not have a role to play in pure contract disputes, hence, franchisees with disputes based on a breach of contract have to pursue private remedies with no recourse to the ACCC.

Arguments in favour of all aspects of mediation remaining confidential

- May make mediation attractive to users who wish to avoid publicity

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[1] *Trade Practices (Industry Codes - Franchising) Regulations 1998* under s 51AE *Trade Practices Act 1974* (Cth).

[2] Evidence to South Australian Inquiry (Oral submission, 14 November 2007, Max Baldock and John Brownsea, State Retailers Association of South Australia).

[3] Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Franchising Code Conduct of Conduct (ACCC Submission, September 2008) 20.

[4] Evidence to the Commonwealth Inquiry, (Submission 12. Dr Elizabeth Spencer)

[5] *Trade Practices (Industry Codes - Franchising) Regulations 1998* Clause 4.1 of Appendix A.

- May increase willingness of parties to enter mediation and engage in open and frank negotiations in the knowledge that disclosures cannot damage them publicly among competitors, acquaintances or interested outsiders, or other franchisee
- Where mediation occurs in the litigation context it provides the parties with a safe space in which to make disclosures, propose and respond to offers and engage in negotiations, all without threat of the evidence being used against them in the court or tribunal proceedings
- May make mediation more effective by encouraging parties to be frank about their real needs and interests

The value of information being disclosed about franchise mediations includes

- Enabling prospective franchisees to form a contextualised conclusion about the level and type of disputes within a specific franchise system.
- Presenting a more complete picture of the franchise network. A franchisor distracted by numerous mediations is potentially less focussed on the growth of franchisees' businesses than a franchisor that does not have to deal with any significant disputes;
- Facilitating comparison of one franchisor with another and one mediator with another;
- Policy and regulation being evidence-based rather than speculation/anecdote based.
- Confidentiality can create problems for franchisees who are unable to access information about the outcome of similar dispute resolution processes (SA Government), and thus effectively defeat the purpose of the disclosure provisions
- Where there is inequality in the negotiating power during mediation, a mediator can only report to the court that in his or her opinion there was an absence of good faith by one or other of the parties at the mediation. The mediator can not elaborate
- Difficult for a court to monitor a party's compliance with a mediation agreement
- When mediation requires little or no government involvement for administration or enforcement, and it is confidential it is difficult to gauge its effectiveness
- Mediation is easy for franchisors and landlords to control and thus reinforces the imbalance of power in the standard form relational contract. Some believe that mediation only provides the franchisor with another opportunity to assert their dominance, but under a shield of confidentiality.
- Mediation can only be as effective as the respective parties allow it to be. For many franchisees it is the only possible means of being heard – because of the prohibitively high cost of lawyers and litigation.

Current avenues of access to franchise mediation data

Three sources:

1. Surveys of franchisors
2. Reported court cases
3. Government inquiries

1. Griffith University's Franchise Australia **Survey**s are a source of generic data

   – Eg: [t]wenty two percent of [Australia's 1025] franchisors were engaged in a substantial dispute with a franchisee over the past 12 months (that is, a dispute

with a franchisee referred to an external adviser for action). [Of these, matters being mediated accounted for] 21 percent[6]

- Limitation = cannot help with information about specific franchise networks

2. The existence of a **reported court case** may imply that an unsuccessful or only partially successful mediation had occurred; or a judgment may state that the mediation process was by-passed:

   - *Astram Financial Services Pty Ltd v Bank of Queensland Ltd* [2010] FCA 1010 it is possible from Justice Buchanan's reference to documents that were 'prepared for the purpose of earlier, unsuccessful, mediation proceedings' to conclude mediation occurred.

   - *Backyard Concepts Corporation Pty Ltd v. Jim's Group Pty Ltd* [2010] QSC 129, Justice Mullins noted '[a]s the mediation on 10 February 2010 was unsuccessful'.

   - *Alpha Centauri Enterprises Pty Ltd v Mortgage House of Australia Pty Ltd* [2010] NSWCA 188, '[t]he Code does contain provisions for compulsory mediation, but there was no claim made and no evidence that the appellant would have pursued that course to its advantage'

   - Limitations in relying on reported cases for evidence of a franchisor's attitude to mediation are that it takes many years for a litigated dispute to progress to judgment, and that most disputes settle prior to final judgment.

3. **Government inquiries re franchising**

Jennifer Harris and I analysed two 2008 government inquiries, the South Australian[7] and a Commonwealth inquiry.[8] The analysis showed that mediation is of concern for franchise stakeholders. I can provide the full results of our research if the government wishes to see them.

- South Australian inquiry: the submissions raised 797 issues, of which 189 or 23.7 % are mediation related (Buchan and Harris[9])

- Commonwealth Inquiry: the submissions raised 2,377 issues in total, of which 483, or 20 % are mediation related (Buchan and Harris)

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[6] Lorelle Frazer, Scott Weaven, Kelli Bodie, *Franchising Australia 2010*, Griffith University, 13.
[7] Economic and Finance Committee, Government of South Australia, inquiry into the existing laws governing franchising that culminated in Economics and Finance Committee, Parliament of South Australia, *Franchises* Final Report (2008).
[8] Commonwealth Inquiry that culminated in Joint Committee on Corporations and Financial Services, Australian Senate, *Opportunity not opportunism: improving conduct in Australian franchising*, Commonwealth of Australia, December 2008.
[9] Jenny Buchan and Jennifer Harris *Stakeholder input into franchise inquiries: an Australian exploratory study* (Paper presented at the 24th Annual International Society of Franchising Conference, Sydney, Australia. June 2010).

- This concern is transferred to the final reports, with both reports capturing similar percentages of mediation-related issues

- Of the 112 issues raised in the SA Final Report, 25.9 % (or 29) are mediation related

  - Of the 143 issues in the Commonwealth inquiry (above) final report, 24.6 % (or 33) are mediation related

Obviously mediation related issues are of sufficient concern to a number of franchise stakeholders to motivate them to make a submission. Witness testimony provides glimpses into mediation practices within specific franchise networks however table 1 demonstrates the anecdotal and hearsay nature of a significant amount of the information. For example:

- Commonwealth inquiry:

  - The ACCC submission noted that *a* Cheesecake Shop master franchisee had breached the Code by refusing to attend mediation

  - Such information is of very limited value in due diligence. It is limited because it does not convey which master franchisee was involved in the dispute. Nor is the knowledge of the existence of one mediation within a franchise system of 200 franchisees a contextualized picture of Cheesecake Shop's record of disputes within its own system, vis à vis other food retailers, or other franchisors

Table 1 Type of evidence used re franchise-related mediation issues in 2008 Commonwealth and South Australian inquiries

	Submissions				Final Report			
	Cth		SA		Cth		SA	
	N	%	N	%	N	%	N	%
Experience - own	43	**8.9**	16	**8.5**				
Experience - other	55	11.4	19	10.1				
Legal analysis - own	9	1.9	18	9.5	4	12.1		
Legal analysis - other					1	3.0	1	3.4
Scholarly research - own	7	1.4	6	3.2				
Scholarly research - other	131	27.1	10	5.3	2	6.1	1	3.4
Speculation / opinion	137	**28.4**	75	**39.7**	9	27.4	8	7.6
Untested opinion of others			1	0.5	5	15.2	5	17.2
Recommendation	101	20.9	44	23.3				
Reference to submission					12	36.4	14	48.3
Total	483	100.0	189	100.0	33	100.0	29	100.0

Overall the type of evidence used in the two inquiries is very similar. They highlight the dearth of objective, verifiable data sources for engagement with franchise mediation, and franchise mediation processes and outcomes through:

- the substantial **reliance on speculation / opinion**. 28 per cent of all mediation issues raised in the Commonwealth inquiry were based upon speculation or opinion. This percentage was even greater for the SA Inquiry – nearly 40 per cent.
- the **small percentage of evidence from own experience** – less than 10 per cent. This may be explained by the low percentage of people who have experience with mediation or are able to talk about it. Nineteen of the submissions to the 2008 Commonwealth Inquiry wrote about 'gag' clauses in relation to dispute resolution. (Buchan and Harris, 2010)

Commenting on her attempts to conduct research in another ADR arena, Dominique Allen[10] attributed her inability to interview parties to discrimination complaints 'primarily ... to restrictions in the confidentiality agreements the parties sign when they settle a complaint'.[11]

Proposals in Options Paper

OPTION 1 – NATIONAL INFORMATION AND REFERRAL SERVICE

My response

Option 1 is not sufficiently comprehensive. Centralising a referral service would facilitate data collection on the existence of disputes. It would not, however, address the current gaps in areas like disputes between franchisees and the franchisor's administrator and would not capture data about results. This would make evaluation of the effectiveness of the proposed service impossible..

OPTION 2 – NATIONAL DISPUTE RESOLUTION SERVICE

My response

Mediation is an excellent way to resolve disputes but where the stronger party has more money and knows how deep the weaker party's pockets are there is sometimes no incentive for them to agree to the process or to attend with any genuine interest in settling the dispute on a fair basis.

To be effective Option 2 would need to include a power to compel parties to attend mediation; and greater accountability would be required. This could be achieved through better public records.

Are there any significant areas of small business that are not covered by current dispute resolution services?

- Yes, some franchising disputes are not within the jurisdiction of the Office of Franchise Mediation Adviser.
    - The Franchising Code of Conduct ('the Code') provides a mandatory dispute resolution process for **parties to a franchise agreement**.[12] Sometimes the

[10] Dominique Allen (2009) 'Behind the Conciliation Doors: Settling Discrimination Complaints in Victoria' 18 *Griffith Law Review*, 778

[11] Allen (2009), p 779.

[12] Trade Practices (Industry Codes — Franchising) Regulations 1998

parties in dispute are not both parties to the franchise agreement, hence can avoid the Code. Eg the parties may be the franchisor and the franchisee but the dispute arises between the master franchisee and the franchisee, or the landlord and the franchisor (where the franchisee occupies – under licence from the franchisor - the shop that is the subject of the dispute but has no contract-based right to enter the dispute).

- **Businesses under administration.** When a franchisor is placed in administration the administrators routinely ignore the Code obligation to mediate and, instead, go straight to court. Eg the dispute resolution provisions in Code were ignored in the recent 2011 administrator's dispute with 25 Angus & Robertson franchisees – Administrator went straight to court when the franchisees purported to terminate franchise agreements because of the franchisor's anticipatory breach of the franchise agreement.

OPTION 3 – NATIONAL SMALL BUSINESS TRIBUNAL

My response

The definition of small business. Most franchisors would not fit the category of small business even where they present a very lean operation in terms of number of people employed and value of assets. This is because they have significant bargaining power (with suppliers, landlords, banks and franchisees) and the ability to shift risk to franchisees through asymmetrical contracts. Most franchisees, however, no matter how large, would benefit from being able to access cheap dispute resolution. It would be wrong to limit small business disputes by dollar limit; it can easily cost over $100,000 to take a dispute to court, mediation is effective for any size of dispute and franchisee disputes can involve investments by franchisees of up to $1 million.

It would be better to define "small business" by EITHER

- dollar limit, or
- a business where one of the parties has entered the business by signing a substantially standard form relational contract – such as a lease or a franchise agreement. Typically these relationships are offered on a more or less 'take it or leave it' basis by the landlord or the franchisor.

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24 Definitions

In this Part:

complainant means the person who starts the procedure under clause 29.

parties means the complainant and the respondent in a dispute arising under a franchise agreement or this code.

respondent means the person with whom the complainant has a dispute.

27 Code complaint handling procedure

A party to a franchise agreement who has a dispute with another party to the franchise agreement may start the procedure under clause 29.

On Page 19 of the Options Paper it is noted that 'Consultation has suggested that retail tenancy and franchising matters are best dealt with by existing mechanisms'. Clearly numerous disgruntled franchisors and franchisees do not proceed with mediation after an initial call to the OFMA, and their needs cannot be met by the ACCC because their dispute in purely contract based. For these people the existing mechanisms are not attractive so I disagree with the consultants. Retail tenants and franchisees do need additional low cost, speedy dispute resolution avenues for some disputes.

OPTION 4 – SMALL BUSINESS ADVOCATE

My response

This is the best of the four options, but it does not go far enough in relation to data recording and publishing; ie information dissemination and evaluation.

The name could possibly be the Small Business Dispute Advocate.

The European Union's Late Payment Directive noted on page 25 of the options paper is worth considering. Two examples within my own experience would have benefited from this:

- I acted for a supplier of office chairs to one of Australia's retail giants. Having delivered the chairs the retail giant then demanded the supplier allow it 90+ days to pay. The supplier was a small business, dependent on the proceeds of this large order, its bank appointed a receiver after 60 days and the business failed. The cause of failure was the successful tendering for and supplying a large order to one solvent customer that had a company policy of paying small suppliers very, very slowly.
- Some franchisors (eg Allphones; Kleenmaid) structure the franchise relationship as a commission agency. The franchisee's customer makes a purchase from and pays the franchisee. The payment goes not to the franchisee but from the customer direct into the franchisor's bank account. The franchisor then pays a monthly commission to franchisees. The commission is the franchisee's sole revenue stream but the typical franchise agreement does not provide a penalty for late payment of the commission. Effectively the commission becomes a free line of credit for the franchisor.

Final comments

The current veil of secrecy obscuring franchise mediation outcomes is in contrast to other disclosure regimes where alternative dispute resolution ('ADR') is accompanied by a measure of transparency. It is excessive and to a large extent, unnecessary.

For example, Thomas J Stipaowich explains the importance of making data on arbitration,[13] a process otherwise as confidential as mediation, available to the public.

> It relieves distrust, empowers those who are sympathetic, and it steals thunder from your detractors. . . . In B2B arbitration, confidentiality is a constructive and helpful tool. In consumer arbitration, it is anathema. The process can be private, so long as there is the opportunity for evaluation. . . . [T]he availability of Public Awards has permitted us to survey such aspects of the arbitration process as the frequency of arbitrator service, the prevalence of attorney fee awards, the dynamics of defamation

[13] The preferred method of alternative dispute resolution for franchisor franchisee disputes in the USA.

> and discrimination cases, employment awards in general, how forum fees are assessed among the parties, how customers fare in arbitration, outcomes in online trading cases, the results for pro se claimants, . . . and numerous other mini-surveys. The Awards must supply reliable and substantive information, because they are the raw material with which outsiders must work.[14]

Australian franchisees, and possibly retail tenants, sit somewhere between the B2B and the consumer. Prospective franchisees are business consumers;[15] once they have become a franchisee they are in a B2B relationship with their franchisor. In contrast to the availability of Public Awards from investor-broker disputes in the US, the absence of meaningful data about mediations within a franchise system fails to satisfy a broader consumer protection agenda. Consumer protection would require transparency of aspects of mediations. This is increasingly important as few small businesses can afford the time or money to litigate, and, accordingly increasing numbers of disputes will be conducted through ADR.

Some disclosure would not threaten the outcome of franchise mediation, or the process

- For example disclosure, preferably through a central clearing house and directly posted onto a publicly accessible electronic database, could include:
    - The name of the franchisor
    - The native tongue of the parties
        - this would inform policy about producing educational material in a range of languages other than English
        - it would also identify languages that advisers would ideally speak
    - The parties? Eg franchisor and franchisee, or franchisor and landlord, or franchisor and master franchisee, or master franchisee and franchisee?
    - The number of franchisees the franchisor has mediated with in the 12 months prior to the date of the disclosure
    - The number of mediations that resulted in settlement, partial settlement and no settlement
    - The location of the mediations – ie whether they were held at the franchisor's head office or on neutral ground – this can have a bearing on how secure the parties feel. Franchisees can be so disenfranchised by the time a dispute reaches mediation that they think a room is bugged.
    - The name of the mediator(s)

[14] Stipanowich (2004), p 908 quoting Richard Ryder, the Editor of Securities Arbitration Commentator.

[15] 'business consumers' are recognised but not defined in the *Competition and Consumer Act 2010* (Cth) Volume 3, Schedule 2, Part 2-2, section 22 (2).

- Identify the agency or firm the mediation was conducted through
- Changes made to the franchise system as a result of the mediation(s)
- Franchisees that had engaged in mediation should be permitted to answer questions from prospective franchisees about those mediations

I am happy to supply further information and to answer questions. Thanks for the opportunity to make this submission.

“Jenny Buchan”

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