DISPUTE RESOLVERS

Franchising Taskforce
By email: franchising@employment.gov.au

20 September 2019

RESPONSE TO TASKFORCE ISSUES PAPER

Dear Taskforce Secretary,

Dispute Resolution Associates (**DRA**) is responding to the Taskforce submissions as the previous OFMA (Office of the Franchising Mediation Adviser) for the period 1 December 2016 until 30 November 2018.

We are providing our response only in relation to Draft Principle 5.

For the OFMA, I provided the Parliamentary Joint Committee on Corporations and Financial Services (**Committee**), with extensive submissions covering the state of the dispute resolution services and the recommended improvements to provide a resolution process that is fair, timely and cost effective for both franchisees and franchisors.

These included:

- 1st Submission May 2018
- 2nd Submission November 2018
- Confidential Submission (on Committee's request)

Your faithfully

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Are there ways to get a fairer, timely and/or more cost-effective outcome from mediation?

This inquiry specifically addresses mediation processes prescribed under the Code.

Fair

There was no suggestion to the Committee that the existing mediation processes as conducted by mediators appointed by various advisers had been anything but fair. The Committee adopted and affirmed OFMA's comment, that the mediation process will fail by design if one party refuses to engage in the resolution in good faith.

However, many franchisee disputes are not single issue, personal disagreements but very often systemic franchise wide problems (like unprofitable products, quality and price of supplies or computer system faults or failures).

The OFMA advised the Committee that it had been involved in trying to assist multiple franchisees from the same franchise network who have similar complaints about the franchise system or actions of the franchisor. Allowing different franchisees within the same franchise system to bring common complaints together within the same mediation, assists the franchisor to better understand the range of opinions and evens out the power balance that exists between the franchisor and franchisees.

The ACCC recognised that an uneven 'playing field' existed due to the power and resource imbalance between the franchisor and the franchisees particularly in getting information about and the resolution of these franchise-wide problems. In its submission to the Committee of 11 May 2018, the ACCC discussed the utility of multi-party mediations. It stated that:

> *The Franchising Code does not expressly state that mediators may undertake multi-franchisee mediation when disputes of a similar nature arise within a franchise system. The ACCC is aware of Franchisors refusing to attend multi-party mediation on this basis and insisting on addressing disputes on an individual basis. Multi-party mediation has a number of benefits, such as:*
>
> *• assisting to shift the imbalance of bargaining power that exists between the Franchisor and Franchisee when resolving disputes*
>
> *• creating a more efficient process and use of resources.*

Both the ACCC and OFMA recommended amending the Franchising Code to allow a mediator to undertake multi-franchisee mediations when disputes with similar issues arise. This was supported by the Committee which stated (para 15.60):

> *Nevertheless, the committee affirms the recommendation put forward by the ACCC that the Franchising Code be amended to expressly allow a mediator to undertake multi-franchisee mediations when disputes with similar issues arise. Such an amendment would improve efficiency as well as ameliorating the power imbalance that exists between franchisor and franchisee in dispute resolution.*

This is a simple amendment to the Code should be introduced forthwith.

Cost-Effective

The cost of the mediation service provided by OFMA was fixed by agreement with the Commonwealth government as:

> an hourly rate of up to $330 inclusive of GST for each hour of time spent in mediation of the dispute and up to 3 hours for the administration of the mediation process

For the 21-month period from 1 January 2017 to 30 September 2018, the average cost of mediation was $3,184 inc GST (compared to $3,000 in 2008 despite a 20% increase in mediator fees). As each party to the mediation paid half the total fee, a franchisee would pay on average $1,592 for assistance with the resolution of disputes that could involve claims of hundreds of thousands of dollars. The only more cost-effective service in Australia would be that provided in the various State tribunals which unfortunately do not have the jurisdiction to deal with the range of franchising disputes.

Timely

Once a mediator is appointed under the Code there is no requirement for the mediation to begin within any fixed period of time. An improvement would be to change the Code to require the mediation to begin within a certain period, say 28 days after the appointment of the mediator, as is required in say the Oil Code (see clause .

The Committee agreed with this proposal (para. 15.68) saying that:

> *15.68 The committee notes the ACCC recommendation to amend the Franchising Code and Oil Code to require that mediation commence within a specified time period once a mediator has been appointed. The committee notes that the FCA has indicated that it does not object to the proposed amendment. The committee is satisfied by the ACCC's argument that the absence of a time limit in the past has allowed parties to frustrate dispute resolution processes. The committee therefore recommends that the ACCC recommendation be implemented for both mediation and arbitration.*

This amendment should be made to the Code.

For a wider explanation see chapter 2.3, Further Submissions to the Senate Inquiry into the Franchising and Oil Codes of Conduct, Derek Minus, 1 November 2018.

Is there a role for mandatory arbitration when mediation does not resolve a dispute?

It is disappointing that after the extensive evidence, submissions, discussion and clear support from the OFMA, ASBFEO, ACCC and the Committee itself, for mandatory arbitration to be included in the Code, the matter is the subject of a further inquiry.

Instead of examining how this amendment to the Code should be implemented and how quickly it can be delivered, the Taskforce instead, wants to begin the inquiry again, but this time with all the information in private.

The Committee's view about the need for a mandatory arbitration process to supplement the Code was clearly expressed (see para. 15.67):

> *15.67 In terms of how the dispute resolution scheme for franchising could be enhanced, the overwhelming bulk of the evidence from a range of stakeholders strongly argued the Franchising Code be amended to include provision for binding arbitration. In this regard, the committee notes that more modern dispute resolution schemes under the Food and Grocery Code of Conduct and the AFCA both provide for binding arbitration.*

The Committee's recommendation was contained in Recommendation 15.2 (para 15.73):

> *"15.73 The committee recommends that the dispute resolution scheme under the Franchising Code of Conduct remain mandatory and be enhanced to include:*
>
> - *the option of binding arbitration with the capacity to award remedies, compensation, interest and costs, if mediation is unsuccessful (does not exclude court action);"*

In support of this recommendation the Committee set out its arguments in the report:

> *15.62 However, the committee agrees with the view put forward by OFMA, namely that a necessary condition of mediation is that the parties be willing to negotiate in good faith and try to achieve an outcome. Where this condition is missing, the mediation process will fail by design. Indeed, the evidence to this inquiry included a litany of instances where one party alleged the other party failed to engage in good faith in the mediation process, knowing that the only alternative was court action which was prohibitively expensive for one of the parties. In effect, the party in the stronger position had no incentive to reach a negotiated settlement and could effectively say to the weaker party, 'take it or leave it', or 'take it to court'. To be clear, most of the allegations put to the committee alleged that the franchisor refused to negotiate in good faith with the franchisee. In other words, the franchisor had a vested interest in impeding mediation because they knew the franchisee could not afford to take them to court.*
>
> *15.63 It is in these circumstances, where all the issues are unable to be resolved satisfactorily through mediation, that a determinative procedure such as arbitration is required. Arbitration works in those situations where a party wants an investigation of the facts and a determination on the evidence.*

15.64 The committee accepts that arbitration is more expensive than mediation because of the time and expertise required. But, it can deliver finality to parties who want to resolve a matter and move on. And arbitration is far cheaper and more flexible than pursuing court action, and this is the critical cost comparison in any attempt to deliver justice in a timely fashion at a reasonable price. Indeed, many of the concerns raised in the committee's 2008 report have now been addressed by a number of developments in arbitration during the ensuing decade.

15.65 Furthermore, the addition of arbitration within the overall dispute resolution framework for franchising would, in all likelihood, increase the number of satisfactory outcomes achieved through mediation. In addition, referral to arbitration would help level the current uneven playing field where many franchisees cannot afford to take franchisors to court, or defend themselves, when franchisors take them court. To prevent this scenario, the committee considers that the Franchising Code should include a requirement that franchisors should have to demonstrate to the court's satisfaction that the matter could not be resolved through mediation or arbitration. If the franchisor is not able to do that, the court should direct the parties to mediation or arbitration. In this regard, the committee suggests that similar to mediation, arbitration must be conducted in Australia and should only be conducted in the state or territory in which the franchisee's business is based to be consistent with existing Franchising Code provisions on the jurisdiction for settling disputes.

The Taskforce should go ahead with examining the feasibility of implementing this recommendation.

For a wider explanation see chapters 3.1, 3.2 and 3.3, Further Submissions to the Senate Inquiry into the Franchising and Oil Codes of Conduct, Derek Minus, 1 November 2018.

Should all dispute resolution services be supported by a levy paid by franchisors, if one is introduced, or only some services?

The answer to this question is No.

There is no need for a levy. There was never any discussion before the Committee about a levy. No evidence was presented to the Committee about the need for a levy. It is not required to support the provision of the existing or any proposed dispute resolution services.

In comparison to the recommendation for the Code to include mandatory arbitration which was supported by the ACCC, the ASBFEO and the OFMA. The proposal for an industry wide levy to fund dispute resolution process was never proposed, discussed examined or supported.

It is a curious recommendation, as a careful search of the entire text of the Committee's report finds no other reference to this consideration other than in the recommendation itself. Put another way, the recommendation for an industry levy is not supported by any evidence, or any mention of the need, facility, practicality or desirability of such a scheme. The only place that the word 'levy' is used in the entire 369 pages of the Committee's report is in recommendation 15.1 itself. As well, none of the 217 published submissions referenced a levy to fund the dispute resolution processes.

An Evidence Based Approach

It is suggested that it is preferable for the Taskforce to adopt an "evidence based" approach which considers the statistical information regarding the extent of disputes in the Franchising Industry that was presented to the Committee by the OFMA. This data was collected in the course of the role of the Mediation Adviser for the 21-month period from 1 January 2017 to 30 September 2018.]

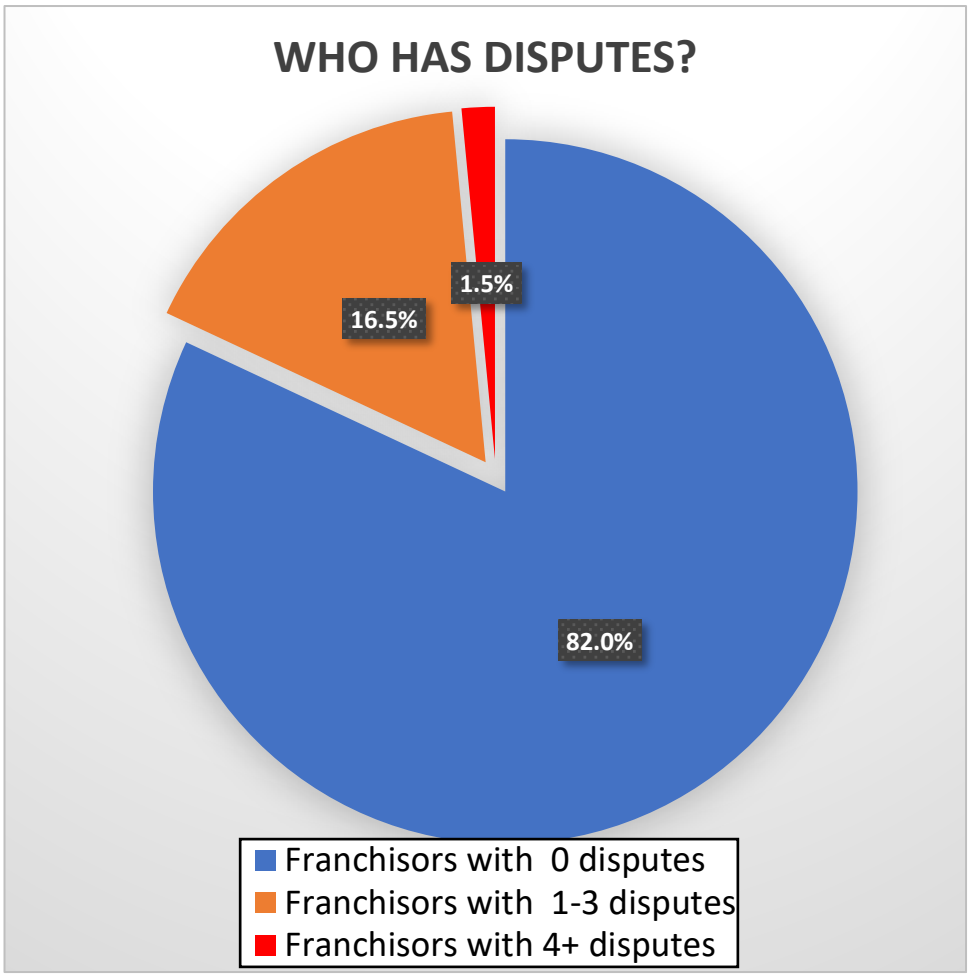
See Chapter 2.2 of Further Submissions to the Senate Inquiry into the Franchising and Oil Codes of Conduct, Derek Minus, 1 November 2018 and which were reported at para 15.6-15.9). To assist the Taskforce and better illustrate the significance of this evidence, I have displayed it graphically.

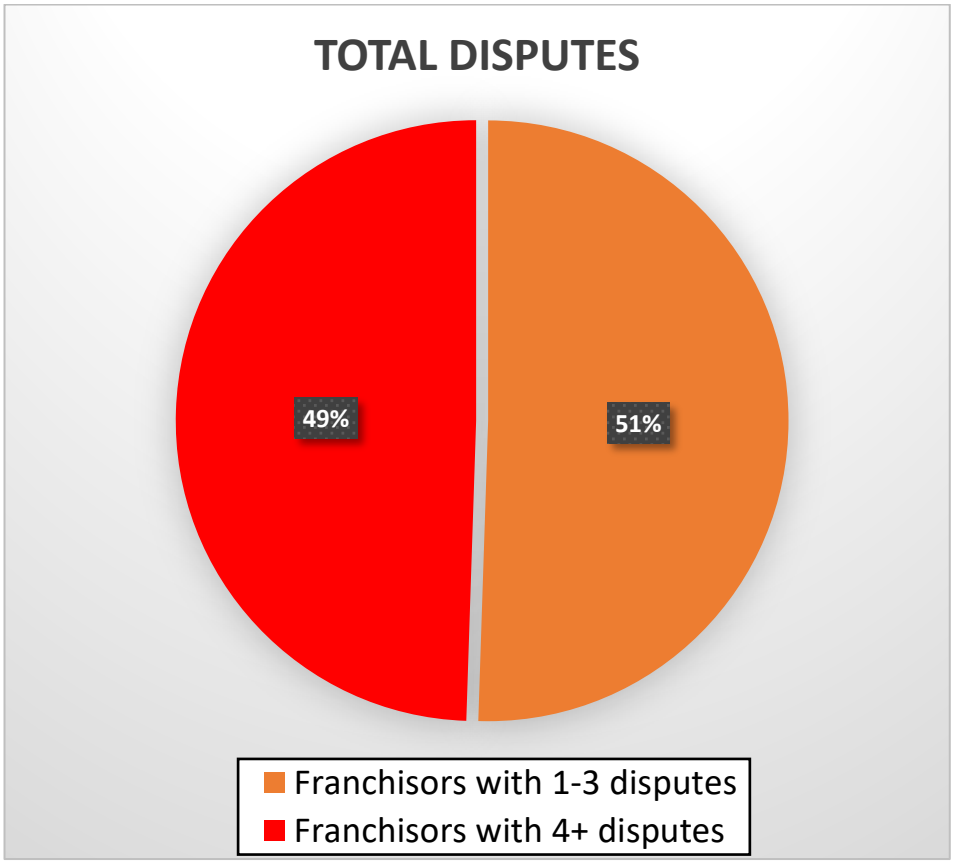
As the first chart illustrates, 82% of the Franchise systems operating in Australia had NO disputes that were referred to OFMA in the period these statistics were recorded.

That does not mean that they are not incurring costs in resolving disputes that do arise, which do in even the best run franchise systems. As the CEO of McDonalds Australia reported to the Committee (para. 15.4) *"the franchisor has 'robust discussions debating the importance and priorities of our plans, and we disagree with our franchisees regularly'."*

Franchises may be bought back or compensation paid and legal costs incurred in getting advice and negotiating outcomes. It would be inequitable for 'good' franchisors who are managing their own disputes to be penalised through the imposition of a levy to fund a dispute resolution service for those franchisors who are generating the disputes.

Next were those franchisors with 1, or 2, or 3 disputes (the orange segment) which in total numbered some 244 franchisors or 16.5% of all franchise systems. These franchisors generated half of all disputes in the 21 months, an average of 1.5 per year.


WHO HAS DISPUTES?
1.5%
16.5%
82.0%
Franchisors with 0 disputes
Franchisors with 1-3 disputes
Franchisors with 4+ disputes


TOTAL DISPUTES
49%
51%
Franchisors with 1-3 disputes
Franchisors with 4+ disputes

It is the effect on the franchisors with 4+ disputes (the red segment) that is the most striking. These 17 franchisors, or 1.5% of the total franchise systems generated 49% of all disputes, dealt with by the OFMA.

As was endlessly reported to the Committee, these franchise systems were in dispute with their franchisees because in the relationship of generating and claiming value, the franchisees were generating the value and the franchisors were claiming it (but not sharing it) through increased fees, kick-backs, churning franchisee sites, reduction in services or providing inferior products (frozen cakes instead of fresh ones).

Is there an alternative?

Rather than an impost on the industry of a financial levy and the implementation of an unnecessary legislative and reporting burden - there is a simpler way. to support franchisees, have disputes resolved quickly and more cheaper and make the organisation that cause problems directly responsible for the financial cost of resolving them.

Amend the legislation so that the franchisor would be required to pay the cost of the mediation or arbitration process (to be introduced).

For mediation this would be the entire cost of the $3,184 average mediation cost. As the franchisee currently pays half this fee, this would be an additional cost of $12,592 to be paid by the franchisor for each mediation it participates in.

What would this cost:

- For 80% of the franchisor systems the cost would be $0.
- For the 16% of franchisors that have an average of 1.5 disputes a year, that cost would be $2,388 annually.
- However, for the 1.5% of franchisors (the 17 companies) that are creating multiple disputes which are not being resolved, the costs could be considerable.

That is as you would want it to be. Because franchisors are in a privileged position. They have knowledge about their network, from every single franchise business they have licensed. They can form the view quickly how and why a franchise is failing, if rent is too high, staffing inappropriate.

They have 3 chances to resolve any dispute that arises quickly and at least cost:

First there is the three week “negotiation” period that is available from the time that a Notice of Dispute is lodged with the franchisor and before a mediator is engaged with no external costs are incurred.

Second there is the mediation period, where the dispute can be resolved at a one-day mediation for an average cost of $3,184. If there are multiple disputes in the network involving similar issues, the franchisor could use the proposed change to the code for multi-party mediations, to bundle all of the disputes into a single mediation with significant cost savings. More significantly, the pressure would be on the franchisor to resolve the disputes quickly (and inexpensively) before they escalate.

Thirdly, at arbitration. Assuming a fixed price, fixed time period, managed arbitration with a single arbitrator, this would be a more expensive option than mediation so the franchisor would be under pressure to operate in good faith and try to resolve the dispute earlier than having to have the matter taken to an arbitration for a legally binding determination.

Instead of the present situation, where a small group of franchisors are not settling the disputes they have created because they know that the franchisees do not have the financial resources to take the matter to litigation, it would be the franchisors who would be under immediate financial pressure to fund the cost of multiple arbitrations to resolve the disputes that they refuse to engage with in good faith.

It is right and appropriate that those franchisors that have generated the greater number of disputes should be required to pay for resolving them (much like those responsible for oil spills are required to make a contribution to clean up the mess they have created).

However, the fundamental issue is not about funding but availability of appropriate dispute resolution processes.

Take for example the franchisor who had taken prepayments of up to $150,000 from each of some 40 to 80 franchisees to fund the development of the business and which they had delayed or failed to complete. It was very difficult for any franchisees to obtain any agreement to be repaid in mediation. (Although I know of one who did as she rang me to thank me for appointing a highly competent lawyer/mediator who extracted from the franchisor not only a Deed of Agreement for payment but also a Personal Guarantee as well).

As the OFMA, I personally conducted a telephone conference with 10 of this systems franchisees, who after I carefully explained the ways in which the OFMA could assist their negotiations with the franchisor, all elected **not** to proceed in any manner which might antagonise the franchisor, dependent as they were on him moving ahead with their businesses for which they had been waiting for over 2 years.

Without the ability to make an application to an arbitration where a determination could be simply and quickly made according to law, they were stuck in limbo.

Nor is this problem solved by increased regulation and large fines. Post the Inquiry, the franchisor is the subject of freezing orders and an investigation by the ACCC. The late entry of the ACCC into the fray will most likely lead to the liquidation of the companies (which are already in administration) and the total loss of all monies paid by the franchisees.

It has been reported that the franchisor (and the money) has now gone overseas where new companies have been set up by the franchisor to fund growth overseas.

A single Dispute Resolution organisation

The need for a levy appears to be for the funding of the dispute resolution service to be provided by:

> *"one body (a merger of ASBFEO and OFMA) to manage the dispute resolution process, potentially creating efficiencies and increased awareness about dispute resolution under the Code"*

This was never "recommended" by the Committee. In fact, in the penultimate paragraph of the dispute resolution chapter, which appeared right before this recommendation, the Committ stated that: *"While the committee notes the evidence it received that proposed OFMA be merged into ASBFEO, the committee does not have a firm view on what the best outcome would be."*

Although this merger appears a simple objective, there are significant difficulties surrounding this proposal. For a wider explanation see chapters 1.3, Further Submissions to the Senate Inquiry into the Franchising and Oil Codes of Conduct, Derek Minus, 1 November 2018.

The charter of the *ASBFEO* establishes it as an advocacy body not a dispute resolution body.

To the extent that the Committee considered it, their view was that

> The ACCC acknowledged that when it considered a dispute could be resolved by mediation, it referred parties to not just OFMA, but also ASBFEO and the various small business commissioners because they all offer similar services (see para. 15.55)

In terms of its own role, the ASBFEO was only recently reviewed (see the report commissioned by Treasury: Review of the Australian Small Business and Family Enterprise Ombudsman, June 2017).

That report specifically considered whether the role of the ASBFEO should be expanded to undertake the functions currently provided by the Mediation Adviser.

The Report concluded (para 2.4.1):

> *There is no evidence of a gap in the ASBFEO's assistance function at present. One stakeholder suggested the ASBFEO's assistance function should expand to include dispute resolution services under the Franchising Code of Conduct, the Horticulture Code of Conduct and the Oil Code of Conduct, which are mandatory industry codes of conduct prescribed under the Competition and Consumer Act 2010. A mediation adviser provides dispute resolution services under the codes, informing parties of the dispute resolution procedures available to them and, where the parties request mediation, nominating a specific mediator. However, expanding the assistance function of the ASBFEO is considered infeasible due to differences in:*
>
> - *the roles of the ASBFEO and the mediation adviser in mediation*
>
> *– The Act provides for the ASBFEO to recommend a group of dispute resolution providers and the parties to the dispute must choose the provider. In contrast, the mediation adviser must nominate a specific provider which the parties to a dispute must use.*

- *the types of parties to which the ASBFEO and the mediation adviser provide dispute resolution services*

  – The Act limits the ASBFEO to assisting small businesses, whereas the mediation adviser can assist all businesses, small or large, as well as consumers. This highlights that combining the disputes resolution services of the ASBFEO and the mediation adviser would require both legislative change and a fundamental change in the ASBFEO's role. If the ASBFEO's assistance function was strengthened in future to include in-house mediation or adjudication for example, many stakeholders would no longer consider the current arrangements to separate it from the advocacy function to be adequate. Given this risk, the ASBFEO's assistance function should only expand in response to a clearly identified gap.

A word about the Numbers

Remarkably, for an industry which has been in the centre of attention of the Australian Parliament for the past 10 years through various inquiries and which reportedly generates over $182 Billion in economic value for the Australian economy there is no reliable current figures on the number of franchisors even operating in the industry or the numbers of disputes. Even the Taskforce had to pay a commercial service (IBISWorld) to provide the basis statistical information it relied upon

That is why the Federal Parliamentary Joint Committee investigation into the Franchising Industry inquiry in 2008 recommended that the ABS be tasked with keeping statistics on the industry.

They said:

> **Recommendation** 7 (paragraph 7.28)
>
> *The committee recommends that the government require the Australian Bureau of Statistics to develop mechanisms for collecting and publishing relevant statistics on the franchising sector.*
>
> *Improved collection of statistics on franchising in Australia, with a focus on disputes and dispute-related unit franchise turnover, will help in developing a better understanding of how extensive disputation truly is.*

We again commend this recommendation to the Taskforce.