FIB 2010 Sub 62

ThomsonsLawyers

Sydney
Melbourne
Adelaide

Our Ref: SMO

24 January 2011

The Inquiry into the Franchising Bill 2010

Economics and Industry Committee

Legislative Assembly

Dear Committee,

I am a partner at Thomsons Lawyers. I have been actively involved in the franchising industry for in excess of 12 years, especially in the area of dispute resolution.

I have represented franchisors and franchisees in most jurisdictions across Australia. I am a long standing member of the NSW Chapter of the Franchise Council of Australia (FCA) and a member of the FCA legal committee. I am a qualified mediator, on the panel of the OMFA and have mediated franchise disputes.

As a leading franchise lawyer, I feel obliged to comment on the The Franchising Bill 2010 ("the Bill"), being the private members bill introduced by Mr Abetz. The views expressed in this submission are those held by me personally. In summary, the Bill poses a number of threats to the franchising industry and will undoubtedly create additional costs and uncertainty for all stakeholders in the industry.

The purpose of this submission is to highlight what I consider to be the key issues associated with the Bill. I am aware that many other people and organisations have written about the Bill, however, I commend to you the submissions made by the Queensland Law Society which I consider to be an excellent analysis of the Bill and objective in nature.

For the record I cast no aspersions as to the intentions of Mr. Abetz, nor the draftsperson of the Bill. I am aware through the media of the dispute involving Competitive Foods concerning its inability to renew its franchise agreements but I have no direct knowledge of the precise issues in dispute. However, it does appear that certain aspects of this Bill will benefit Competitive Foods and other franchisees who have existing disputes about renewal of franchise agreements. This is why retrospectivity of any legislation should be avoided because of the uncertainty it creates. It's like changing the rules of a football game at half time!

Level 25, Australia Square Tower, 264 George Street, Sydney NSW 2000 Australia
GPO Box 3909, Sydney NSW 2001 Australia • DX 69 Sydney
T +61 2 8248 5800 • F +61 2 8248 5899 • www.thomsonslawyers.com.au

Good Faith

The definition of 'Good Faith' in the Bill is entirely uncertain, far too wide and well beyond the current state of the common law. A statutory requirement of 'Good Faith' was also specifically rejected by the Federal Government when considering amendments to the *Franchising Code of Conduct* last year.

A recently retired High Court judge (Justice Kirby) highlighted the fundamental problem and said of a general contractual duty of good faith:

> *"In Australia, such an implied term appears to conflict with fundamental notions of caveat emptor that are inherent (statute and equitable intervention apart) in common law conceptions of economic freedom."*

The proposed definition of Good Faith in the Bill, in extending to a duty to act "cooperatively" goes even further that what the Courts have considered. To require a party to act "*fairly, honestly, reasonably and cooperatively*" is far too onerous. In effect is to require them to act, not in their own interests, but in the interests of the other negotiating party. Common sense points to the need for commercial parties to be free to protect their own best interests, not be constrained to "cooperate" with their counterparties.

For example, would the duty require a franchisor to take on an unsatisfactory franchisee (eg someone who self evidently lacked the experience or capacity to conduct the intended business) just because the intending franchisee wanted to take up a franchise? A duty to cooperate in an area where interests can and do conflict, simply creates uncertainty and confusion.

The potential uncertainty is compounded by the generalised and vague descriptions of when the duty is activated. What is intended by a "*dealing*" or a "*negotiation*", and how these terms relate to each other, and the level of connection with the matters in the subparagraphs that follow, raises more questions than it answers. How can parties to a franchise agreement possibly know if they have acted contrary to this provision, and leave themselves exposed to a monetary penalty, when it is so vague?

It should never be overlooked that a franchise agreement involves two (or more) freely contracting parties. In an age where people are better informed, better educated and access to information is easy, the definition proposed is well beyond what is required to regulate proper business behaviour. It is also worthy to query why "Good Faith" has to be introduced into franchise relationships when other business activity does not have the same regulation.

Civil Monetary Penalties

The ACCC has similar powers to make orders for civil monetary penalties as described in section 12 of the Bill. Questions of constitutionality are thus raised and must be considered carefully before the Bill is passed.

However, even assuming the WA parliament could pass such a provision, the question remains whether State Courts should given the Federal laws already in place. Those laws are new and not enough time has passed to determine the effect on business behaviour.

Assuming constitutionality, the Bill also raises the spectre of duplicity of investigation and penalty. For example if there is an order made for payment under the proposed Bill, and subsequently an ACCC investigation concludes with proceedings and an order for payment, the Bill gives no consideration as to how the two penalty provisions should work together.

Clause 12(2) is not sufficient protection. The potential for duplicity of both an investigation and payment is particularly concerning. Investigations and litigation of any kind is stressful (for all parties) and costly. To create the opportunity where a party can be investigated twice, for the same breach, is clearly to be avoided. .

Injuctions

Section 13(2) of the Bill provides that "*the Court cannot require the applicant to give an undertaking as to damages*". Undertakings as to damages are one of the cornerstones of protection for a person who is the subject of injunctive relief. There seems no genuine basis whatsoever to depart from this well established common law requirement. Injunctions are court imposed prohibitions and are only granted in limited and 'special' cases, and for good reason, as they can seriously impact business dealings. Undertakings as to damages are an important hurdle for any claimant; it warns of the seriousness of what is being sought and the potential for serious economic impact on the injuncted party if a claim is ultimately found unmeritorious.

Taking away this protection for persons affected by injunctions may have the unintended effect of making judges more reticent to grant them. Although I have the utmost faith in the judicial system, judges know that initial impressions (as on an injunction application) can prove mistaken, or be affected by later known events. Mistakes have even been known to happen from time to time. Currently, a wronged defendant at least has some protection to recoup their losses via the undertaking.

Loss of the undertaking may also encourage applicants to make applications based on less stringent, or even misleading, evidence. If the only downside to an applicant is the loss of the injunction, there is the real risk an applicant will be less diligent in ensuring there is a proper basis for their application. A defendant needs to be given appropriate protection to ensure that an application is not brought unneccessarily or frivously.

Ultimately, the decision to grant or withhold an injunction should rightly rest in the hands of a Judge who can balance the interests of the applicant (in obtaining a legally enforceable order restraining another's conduct) and the defendant (in not being subjected to such restraint without at least some protection against wrong). As part of this balancing exercise, a Judge can make a determination about the appropriateness or otherwise of the undertaking sought. However, to categorically deny an undertaking as to damages be given, is to tie a Judges' hands in making that judgement.

Redress Orders

The redress orders under the proposed section 14 of the Bill are also ill conceived.

There are again constitutional problems created by the references to Federal laws without proper account being taken of those laws.

The form of order appears to subvert the parties' right to contract and allows an agreement to be forced on a party who doesn't want it. That is not how the law presently works. Only in cases where the court finds there is a concluded agreement but one party refuses to perform it can such an order be made. It is not the role of the legislature or Judges to force agreements on unwilling parties on whatever terms the Court deems appropriate.

The redress orders ignore the commercial realities of business and allow the Court to substitute new contract terms "*as the court decides is just having regard to the terms of the*

old agreement". It also potentially changes the deal that may have been agreed on equal bargaining terms many years prior. This cannot be good for business certainty.

In order to prove that a term of an agreement is reasonable and a party has acted in "Good Faith" commercially sensitive and confidential information may have to be produced to the Court as evidence. This may not seem of great significance but for some Franchise systems their competitive advantage may be lost if confidential and sensitive information has to be disclosed in the defence of a claim.

There is also no guidance in the Bill as to what the Court may consider in determining actions brought under the intended sections 12, 13 and 14 of the Bill. This creates all types of interpretation scenarios. Case law will be required to give guidance for future actions. This is likely to mean that many litigated disputes will proceed to hearings because of differing interpretations about certain conduct. Protracted litigated disputes should be avoided as it is damaging for the franchise sector and obviously stressful for those involved..

Section 14 (4) of the Bill is expressed to act retrospective. The opportunity for the Court to make a redress order up to six years "*after the date on which the act or omission...occurs*" cannot become law. This also holds true with respect to section 14(5) of the Bill which allows a Court to make an order for redress if "a person has suffered, or is likely to suffer, loss or damage as a result of an act or omission described under section 12(1) or 13(1)". The Explanatory Memorandum, nor the proponents of the Bill make any justifiable case why the Bill needs to be retrospective.

Retrospective law should be avoided at all costs. It is inconsistent with the principles of natural justice and fairness. The Federal Government has acknowledged this fact when introducing the most recent changes to the *Franchising Code of Conduct*. Why create confusion on this issue when the Federal Government has clearly stated that franchising laws should not be retrospective.

Damages for harm due to contravention of this Act

Section 15 of the Bill provides that should a person suffer harm as a result of an "*act or omission of another person*" who contravenes the Bill then that individual has a cause of action against that person for damages for the harm.

The definition of "harm" is wide and includes personal injury, physical or mental impairment, property damage and economic loss. This provision contemplates a major departure from the type of harm a contracting party can presently be liable to compensate for. The need for such an extension in the area of franchising alone is not justified. It is a serious threat to business certainty, especially when the retrospective aspect of the Bill is considered. The common law for hundreds of years has sought to protect the freedom to contract and severely limit the ability to claim damages for alleged personal injury arising solely from breaches of contract.

Furthermore, problems with escalating insurance premiums caused by an ever increasing number of claims from relatively minor personal injury claims led to personal injuries law being extensively modified in all jurisdictions so as to limit the type of claims which can be brought. This proposed provision entirely disregards the rationale for those modifications and seeks to undo them in the area of franchising. Again, why this preferential treatment is required is entirely unclear. It is completely unnecessary to create personal injury legislation in what is already complex area of law.

Finally, the right for "*any person who suffers harm*" to sue under this Bill is not limited to those who are a party to a franchise agreement. The potential scope for claims by any person who suffers "*harm*", for example a landlord renting to a franchisee, is too wide.

Summary

In summary, the Bill should be withdrawn or substantially re-written as the current Bill creates great uncertainty and the likelihood of significant litigation. State based legislation concerning franchising is a step backwards, no matter how meritorious the intentions of the proponents.

Australia, in commercial terms, is still a small country. Franchising has been embraced by Australians and many franchise systems operate nationally. Franchising has been a successful business model because of the certainty provided by national regulation. If changes need to be made then they should be done at a Federal level, not at a State level. The recent introduction of the Australian Consumer Laws should alert the WA government that national based laws are the future, not specific state based laws.

I would be happy to discuss any or all of these matters with you or any other interested party at your convenience. I must acknowledge the assistance of my colleagues Mark Hamwood and Eliza Garrett in the preparation of these submissions.

Kind regards,
THOMSONS LAWYERS

Sean O'Donnell
Partner
T +61 2 9020 5770