HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Reference: Fair trading

CANBERRA

Monday, 24 March 1997

OFFICIAL HANSARD REPORT

CANBERRA

HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

Members:

Mr Bruce Reid (Chair)

Mrs Bailey	Mr Jenkins
Mr Baldwin	Mrs Johnston
Mr Beddall	Mr Allan Morris
Mr Martyn Evans	Mr Nugent
Mr Richard Evans	Mr O'Connor
Mr Forrest	Mr Zammit
Ms Gambaro	

The committee will inquire into business conduct issues arising out of commercial dealings between firms, including claims by small business organisations that some firms are vulnerable to and are not adequately protected against 'harsh or oppressive' conduct in their dealings with larger firms.

1. The committee is asked to investigate and report on:

the major business conduct issues arising out of commercial dealings between firms including, but not limited to, franchising and retail tenancy;

the economic and social implications of the major business conduct issues particularly whether certain commercial practices might lead to sub-optimal economic outcomes.

2. The committee is asked to examine whether the impact of the business conduct issues it identifies is sufficient to justify Government action taking into account, but not limited to :

existing State and Commonwealth legislative protections;

existing common law protections;

overseas developments in the regulation of business conduct.

3. The committee is asked to examine options and make recommendations on strategies to address business conduct issues arising out of dealings between firms in commercial relationships, taking into account, but not limited to:

the potential application of voluntary codes of conduct, industry self-regulation and dispute

resolution mechanisms, including alternatives to legislation and court-based remedies, and mechanisms to support these measures;

legislative remedies.

4. In developing options, the committee will seek to ensure certainty in the market place, contract dealings and other commercial transactions, minimise the regulatory burden on business, and keep litigation and costs to a minimum.

WITNESSES

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CANBERRA

Monday, 24 March 1997

Present

Mr Reid (Chair)

Mr Beddall	Mr Jenkins
Mr Martyn Evans	Mr Allan Morris
Mr Forrest	Mr Zammit
Ms Gambaro	

The committee met at 9.02 a.m.

Mr Reid took the chair.

AXIOMAKAROU, Mr Jim, Competition Policy Branch, Structural Policy Division, Department of the Treasury, Parkes, Canberra ACT 2600

BERKELEY, Ms Brendalyn, Acting Assistant Secretary, Securities Markets Branch, Business Law Division, Department of the Treasury, Parkes, Canberra ACT 2600

MAHER, Mr David Anthony, Competition Policy Branch, Structural Policy Division, Department of the Treasury, Parkes, Canberra ACT 2600

PARKER, Mr David, Assistant Secretary, Competition Policy Branch, Structural Policy Division, Department of the Treasury, Parkes, Canberra ACT 2600

CHAIR—I declare open this final public hearing of the inquiry into fair trading. Today the committee will take evidence from the Treasury—which has portfolio responsibility for business law—and the ACCC—and from Mr Robert Gardini, the former Chairman of the Franchising Code Council and a practising lawyer. I welcome witnesses and observers here this morning. I now call representatives of the Treasury. The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself demand.

Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament. The committee prefers that all evidence be given in public but, should you at any stage wish to give evidence in private, you may ask to do so and the committee will give consideration to your request. Do you have any comment on the capacity in which you appear before the committee?

Mr Parker—The Treasury branch of which I am Assistant Secretary has responsibility for competition policy, and that brings with it responsibility for oversight of the competition functions of the ACCC. Mr Axiomakarou and Mr Maher are two of the legal experts in the branch, and Ms Berkeley's branch has responsibility generally for the Australian Securities Commission, corporate fundraising and the like. Before I proceed to make substantive comments, I would like to express our appreciation to the committee for shifting this hearing from last Thursday to today. We appreciate your indulgence.

CHAIR—If you would care to make an opening statement, please proceed.

Mr Parker—I thought that I might mention the context of Treasury's interest in fair trading issues. Treasury does not have general responsibility for the fair trading or consumer protection provisions in the Trade Practices Act; that falls directly to the Minister for Industry, Science and Tourism. However, we do have a general interest in the issues from a couple of perspectives. We are responsible for much of the remainder of the Trade Practices Act, and there are some linkages between fair trading issues and competition issues—and, in particular, the ACCC is one of the Treasury portfolio agencies.

As I mentioned, we are interested in fair trading, firstly, because it can have some competition implications—and perhaps we will discuss some of those further this morning—and because, more generally,

fair trading laws and fair trading issues can have an effect on economic performance. Secondly, the prospective removal of price surveillance in the petrol industry raises a number of fair trading issues, and the operation of the Prices Surveillance Act is something which falls directly under our responsibility. Thirdly, the issue of a linkage between franchising codes and prospectus requirements under the Corporations Law is something which falls directly under the responsibility of my colleague from the Business Law Division. With that as background, I thought I might make a couple of general thematic points about the context of our submission to the inquiry, which would set the scene for any subsequent and more particular comments which we could make in response to any questions that you might have.

We have had a look at many but not all of the general submissions to this inquiry, and one observation which we would make on them is that the pattern in those submissions is fairly much as one might expect. Broadly speaking, submissions from those persons representing big business or franchisors tend to argue that the law is presently broadly all right and they suggest some possible changes at the margin. At the other end of the spectrum, those submissions representing small business tend to say that things are dreadful and they advocate very substantive changes to the fair trading laws and, in particular, they advocate a law to prohibit harsh and oppressive conduct.

Those in the middle of that spectrum—and I would put Treasury in that class—broadly conclude that there are some particularly pointed problems in this area, but they are not simple problems and they come from a variety of sources. Firstly, the present patchwork of laws may be inadequate in a number of respects but, equally, it seems to be the case that the existing laws have not been extensively used; and, amongst other things, this to us points to a problem with access to justice. Secondly, there are quite complex problems about access to, and the use of, information by small business persons contemplating entering into a long-term business relationship. Thirdly, with some of the industry based solutions, problems have emerged with inadequacies in the code of conduct or in the institutions supporting those codes. I imagine that Mr Gardini, appearing later today, will be able to throw some useful light on the latter point.

These middle of the road submissions, including Treasury's, tend to argue that these problems, or at least some of them, can be addressed through reforms which address the causes of the problem: access to justice; access to, and use of, information; and fixing up the content or institutional structures of the code. But, equally, these submissions generally recognise that the issue of an imbalance in bargaining power—which often lies at the heart of some of the concerns—cannot be simply addressed.

In particular, there is a great reluctance in our submission and in many of the other central submissions, about the introduction of a law which would prohibit harsh or oppressive conduct in commercial dealings. The concern is that such a law could require courts to remake contracts based on their content alone as opposed to the circumstances of their making.

The courts have generally been reluctant to take that step of going beyond procedural unconscionability to substantive unconscionability to examine the content of contracts alone and, in our view, that is an entirely appropriate reluctance. Defining what is harsh and oppressive conduct and what is normal hard bargaining is very difficult. I might add there that normal hard bargaining is, from an economy wide perspective, a highly desirable driving force in our economy.

It is instructive to note that the submissions vary quite widely on what exactly is harsh and oppressive conduct, what that conduct is and what a law would do or would not do if it prohibited it; that is, such a law would engender very considerable uncertainty. Moreover, we think that such a law could give rise to serious unintended consequences, including potentially harming those that it was intended to protect, including by reducing the incentive to deal with small business.

As a general point, in our view it is better to focus on remedies which alter the environment in which a business relationship is formed in order to help businesses conserve their own interest; that is, remedies which go to issues of information requirements, access to justice or through putting in place functional industry codes. We believe that is far better than to regulate the imbalance of power ex post through general harsh and oppressive laws.

CHAIR—As no-one else cares to make a statement at this time we shall proceed with questions. You will recall that the Gardini review of the franchising code of practice identified one of the most serious weaknesses in the fact that the code was a voluntary arrangement and only between 40 and 50 per cent of people in that sector participated in it and registered, and there were no legal remedies available under the code to protect franchisees. Why then do you still maintain your position supporting voluntary industry codes?

Mr Parker—Just before I answer that question, perhaps I could invite Ms Berkeley to make some brief comments on our view as to why we do not think it is appropriate to underpin the franchising code with a narrowed exemption from the Corporations Law prospectus provisions and then that could set the scene.

Ms Berkeley—Certainly one of the recommendations of Mr Gardini's review was to use the existing exemption available to franchises under the Corporations Law from the operation of the prospectus provision as a means of effectively underpinning the franchising code of practice. The idea was that you would only be entitled to that existing exemption from the prospectus provisions of the Corporations Law if you were complying with the voluntary code.

That proposal to the department seems to be an inappropriate use of the Corporations Law provisions. The Corporations Law provisions applying to prospectus arrangements are designed to regulate the securities and futures markets. They really are entirely different markets to the particular arrangements that would be applying to franchising and, in our view, to bring into play a completely unrelated piece of legislation like the Corporations Law as a means of forcing people into the voluntary code of practice would bring into play new regulatory difficulties.

Among those regulatory difficulties we would see the fact that the present prescribed interest provisions of the Corporations Law that we are talking about here are designed to provide protection for passive investors where you have a clear distinction between ownership and control. This is not the case with franchising. As recently as 1994 the Law Reform Commission and Companies and Securities Advisory Committee report entitled *Collective investments: Other people's money* noted that franchises involve a degree of investor involvement in the day-to-day management of their investments and that this made the application of prescribed interest provisions of the law inappropriate.

Franchises are not offered to the public or a section of the public by a discrete organised release, as is the way ordinarily in the securities markets and the prescribed interest provisions that the Corporations Law currently regulates. In addition, the protection offered by the prospectus provisions of the Corporations Law is not equivalent to the protection that is being proposed by the code. The Corporations Law prescribed interest provisions really only deal with fundraising and initial disclosure, whereas the code regulates ongoing aspects of the relationship between the franchisor and the franchisee.

In addition, in the event that there was not going to be sufficient compliance with the code such that you forced franchisors and franchisees into the Corporations Law provisions, you then have an issue of resourcing for the Australian Securities Commission and whether the markets would welcome the diversion of ASC resourcing to the franchising industry, which is not an industry designed to be covered by those Corporations Law prospectus provisions in the first place. In all, we would see it as inappropriate to enforce a voluntary code of conduct dealing with ongoing obligations between franchisors and franchisees by imposing Corporations Law requirements on franchisors who do not register with that code.

CHAIR—So you do not see any problem with legislative backing in terms of a constitutional challenge with legislative underpinning and maybe the suggestion that it would transfer the responsibility of law outside the realm of the executive?

Ms Berkeley—It would depend on the type of law. There were other proposals put about relying on the corporations power to do something different to what we are talking about here. I would not see any particular constitutional difficulties with working in the prescribed interest provisions. There may be more difficulties if you were to look at introducing a different form of legislative proposal relying on the corporations power. In relying on the corporations power you need to have a sufficient connection with that power or other powers that are available to the Commonwealth. You could have a situation where, for example, one of the parties to the franchise arrangement is not a corporation; then you may have difficulty in relying on the corporations power and have to rely on other powers, such as interstate trade and commerce et cetera.

The way that the proposal the Gardini report talks about in relation to prescribed interests would work would be with effect to people who were not going to use the code. The way the law operates is to prevent people offering prescribed interests unless they are a public company and licensed with the Australian Securities Commission. So it would effectively force people who wanted to offer franchises to incorporate as a public company and to become licensed with the ASC. I suppose that is a roundabout way of saying that it depends on which way you do it as to whether you are going to have constitutional difficulties.

CHAIR—Do you have any suggestions as to how giving legislative underpinning to a code of conduct could be done?

Mr Parker—The Treasury submission puts forward one possible mechanism which is something of a hybrid, if you like, between voluntary and mandatory codes of conduct. This is a suggestion that you could have so-called code based undertakings where one would have an industry based self-regulatory code, which could go through some approval process to ensure that the code was functional and met certain minimum benchmarks, and then the participants in the industry could voluntarily offer an undertaking to the ACCC or

some other body to comply with the code. That has some merits in the sense that it deals with one of the shortcomings of some existing voluntary code systems whereby, because there have been no legal obligations arising under the code, there has been no mechanism to enforce compliance with the code once a party has become a party to it.

Under the undertakings type of procedure, failure to comply with the code could be in breach of the undertaking, which would then be enforceable in the Federal Court. That is a model which is being used for other competition functions under the Trade Practices Act. It is a model which is proposed for the regulation of access to infrastructure in the electricity industry and also in the telecommunications reforms.

It would be possible, using that model, to go the next step to make it mandatory if, for example, it was made a condition of the business licence to give an undertaking under the code. This is the way it is proposed to be done under the electricity reforms. That is, you will have federal legislation which provides the overall regulatory framework and you will then have state legislation which compels participation in that regulatory framework; it will compel infrastructure owners to provide access undertakings.

That is a patchwork, if you like, of regulatory powers which gets past any constitutional difficulties: the state legislation which compels participation does not raise any constitutional difficulties, and the federal legislation provides a framework under the Trade Practices Act. So it is possible to put together some sort of patchwork. But, of course, that raises a question of whether the states would be willing to participate in requiring any particular business licence to participate in any sort of undertaking.

I will go back now to answer your first question, which was the framework question of why we prefer voluntary undertakings as opposed to mandatory undertakings. Basically, our view on that is that it is essentially a horses for courses question. We generally have a preference for voluntary codes as opposed to mandatory codes for the following reasons: mandatory codes will tend to be more resource intensive than voluntary codes and there is a question—as there always is in an environment of fiscal restraint—as to whether the additional resources required for a mandatory code are well spent.

The reasons that additional resources are necessary for mandatory codes are, firstly, that in setting up the legal framework for a mandatory code, one will normally have to set up some form of institutional framework to support the process, and institutions are resource intensive bodies. Secondly, cases of voluntary codes developed by the industry, if done well, can have more ownership and potentially more commitment to compliance compared with a mandatory code which, by another name, is simply government imposed regulation on the industry.

Thirdly, voluntary codes can be more adaptive than mandatory codes as circumstances in the industry change. If the industry is putting in place its own code, then it can more easily adapt its code than it could a mandatory code, particularly if a mandatory code has a legislative basis which then requires amendment through some form of legislative action. Also, in some ways a voluntary code can have a better image, and thus more ownership in the industry, than a mandatory code.

To sum that up, our view is that voluntary codes have some advantages over mandatory codes if done well; and, in doing them well, one needs to embed into them some means to enforce them—and that has

tended to be the downfall of some existing voluntary codes. In being prepared to go to a mandatory code, I am rather attracted to the ideas which are in the ACCC submission, which looks at the balance between mandatory and voluntary codes, where they have said that there is a general preference for voluntary codes, but that one could contemplate mandatory codes under four conditions.

The first of those conditions is where the voluntary code has proved to be unsatisfactory or inadequate. My comment on that is that one should first attempt to make sure that the voluntary code is as adequate as it possibly can be—that is, to fix that if possible. The second point the ACCC makes is where there is a demonstrable market failure. Obviously, as we have mentioned in our submission, codes are essentially to address issues of market failure, transactions costs, access to justice, and the like.

The third point that the ACCC raises is where a mandatory code is necessary as an alternative to government regulation or where it is to facilitate deregulation in an industry. I think the general idea behind that is that mandatory codes might be seen as an initial deregulatory step to move back from prescriptive government regulation of a particular industry. However, our view is that it is preferable if possible to go the further step to a voluntary code, if one believes the voluntary code will be adequate.

Mr FORREST—It surprises me that you could put so much faith in voluntary codes. Oilcode is a disaster. The problem is that you have got such a distortion in market power, with large oligopolies and a little fellow down the bottom end. If Oilcode is what you are suggesting with a voluntary code, it is a disaster and is not working.

Mr Parker—There is a range of views about whether Oilcode works; not surprisingly, that depends on where one sits in the industry. I would not come here to suggest that Oilcode is a perfect instrument; I do not think anybody in the oil industry would suggest that. Indeed, there have been moves afoot over a considerable period of time to strengthen Oilcode, to put in issues which have hitherto not been subject to the Oilcode process. The issue of strengthening Oilcode is tied in with the issue of removal of price surveillance in petrol, which is one of the reasons I am particularly interested in Oilcode.

Nevertheless, Oilcode is voluntary and, ultimately, there are no means to enforce it if a party chooses not to comply with it. So what I have suggested is that one of the important features of the voluntary code is that there should be a means to enforce that code. We have suggested in our submission one mechanism to achieve that.

Ms GAMBARO—This is probably a question for Ms Berkeley. On section 46—the major powers—I still need some clarification. Where there is a substantial degree of market power in a market as distinct from, say, in a relationship, can you clarify for me what the definition of market power is? Is it based on percentage of the market?

Mr Parker—Market share or percentage of the market is something that is indicative of market power, but it is not conclusive. Broadly, the question of whether someone has market power touches on the issue of whether they are able to behave in a way differently from the constraints that they would be under if they were in a competitive market. Broadly, it means that they are able to charge more and give less than they would be able to do in a competitive market; that is, they are not constrained by competition.

Large market shares, obviously, can give that power but they do not always give that power. If the barriers to entry into a market are very low, or if, say, there is a significant share of imports in the market, you might, nevertheless, have a company with a significant market share but which is constrained to behaving in quite a competitive way.

The distinction that we have drawn in the submission between power in a market and power in a relationship is really a question of the frame of reference in which you judge that power. Very large companies may have power in a market if they are able to charge more and give less than they could in a competitive circumstance. But that is a general power, as a power to charge any of their customers more and give less.

On the other hand, the question of power in a relationship is much more specific to a particular business relationship and it may depend on the circumstances of that relationship. The example which we give in our submission is an example of the captive retail tenant. The tenant may have no choice but to stay in the retail centre, therefore the retail owner is able to charge them a higher price because the retail tenant faces barriers to exit.

However, if the shop was vacant and someone was coming in, the retail owner could not charge the higher price to someone who was coming in because they would not have general market power. The power in the relationship arose because of the prior captive relationship as opposed to a general economic power of the centre owner.

Ms GAMBARO—Just leading on from the power in the market, how would you classify a major film distributor who has 70 per cent of the market in Australia withdrawing product from an independent cinema? Would you see an abuse of market power there?

Mr Parker—That has been an ongoing issue in Australian competition law. I may have to raise the defence point there that in any of these competition issues it is a very fact rich analysis that one has to do. One has to understand the market, understand the barriers to entry, understand the participants, understand alternative participants and the like. I simply do not have sufficient factual understanding of the particular market that you have asked about to really give an answer—

Ms GAMBARO—What if I said to you that the product was only available from the one distributor, what would you say to me then?

Mr Parker—Maybe I could give you an example of where that section has been used. There was the so-called Queensland Wire case where BHP was, essentially, the monopoly supplier of a particular form of steel which was used to make fence posts. It refused to sell to a downstream fencing post producer, or refused to sell except on unreasonable terms, and that case was taken and its refusal to sell in those circumstances was found to be a misuse of that market power. To the extent that you could translate that circumstance across to the film thing then it would be possible but, again, without having a detailed understanding of that market I would be reluctant to express a firm view.

If you were to ask the same question of the ACCC, who is actually involved in the enforcement of the

law as opposed to the policy of the law you may—

Ms GAMBARO—I did, actually. I do not think I got a clearer answer anyway.

Mr BEDDALL—Queensland Wire was over 10 years ago. There has not been much action since. My point is on voluntary codes, which was touched on earlier. There is a general cynicism in the small business community that voluntary codes favour those people and are supported by those people who have the large market power—that is, the franchisor, the distributor. That is a view that has been put to this committee continuously through this inquiry. Do you know of any voluntary codes that are perceived to be working well? We have not had any evidence where a voluntary code is working well.

Mr Parker—I think that again depends a little on where you sit. If you were to ask the oil companies again—they are obviously at the high end of the market—then they would tend to tell you that they are working well but it could be fixed in some way.

Mr BEDDALL—None of the distributors say that.

Mr Parker—No, none of the distributors say that.

Mr BEDDALL—No. My point is exactly that. The big end of town always says that they are working well because they are not regulated.

Mr Parker—Our response to that is to basically say that the voluntary codes, which have not worked well, have tended to have specific deficiencies. One of the deficiencies which we have pointed to is the ability to enforce that code. Essentially, if it is purely voluntary, if it is just a piece of paper, then any party can walk away from it and they have walked away from it in some circumstances. Our view is that it is preferable if there is ultimately some legal right which attaches to the voluntary code. Then there can be enforcement and that sets up an appropriate framework for the code to operate.

Mr BEDDALL—I am looking for an example. If you are not aware of one now perhaps you can find one and come back to the committee, because we certainly have not been informed of any voluntary code.

Mr Parker—Okay.

Mr BEDDALL—In the past a lot of codes have been started off as voluntary and they usually end up as mandatory because of the problems that arise. But if you have an example we would be delighted to hear of one.

CHAIR—I just want to follow up one other point. You raised the question of the Queensland Wire v. BHP case and that has been a consistent theme through our inquiry. We have had a lot of evidence from witnesses talking about the difficulty for access to the legal system and the high cost of it, particularly with the delays and the delaying tactics where any major corporation can keep on delaying the proceedings so that it is difficult for a small business to take action in the courts to remedy a situation. Do you have any suggestions how small business can obtain access to the justice system at a cost that they can afford?

Mr Parker—I think there are two possible prongs to that: one is representative action under the Trades Practices Act. The existing 51AA—and there is an issue of scope there obviously—provides for representative action by the ACCC; that is, it can take an action on behalf of a small business and it has done so quite recently. There are a number of cases where that has developed: the Jalpalm case, the Ultratune case and the like. That is an evolving area, I think. That said, the ACCC is not a legal aid institution and it cannot take all actions, obviously. However, given the precedent that its action does establish, it should help to temper the environment in which small business is dealing.

The second prong to this is that obviously there are some things which the government can do relating to the general issue of access to the courts—I would not profess to be an expert in that at all. But, more particularly—and this is where we come back to codes, whether they be mandatory or voluntary—an important feature of any code is that it should include a dispute resolution mechanism; that is, it provides for the resolution of disputes without needing to go to the adversarial, time consuming and expensive court process. In the case of Oilcode, as I understand it, the dispute resolution mechanism in Oilcode is one of its successes and has been used on a number of cases to arbitrate disputes between franchisees and oil companies.

Mr ALLAN MORRIS—Just to follow through on those two areas, the first thing is that it is a real concern that companies appear to opt in and out of codes. They drop out of codes when it does not suit them and come back in when it does. That would seem to be a real problem. I do not think it is covered by your system at the moment, because it would require mandatory membership of a code rather than just voluntary.

Secondly, perhaps more importantly, it is question of possible class action under codes. The market power and the legal power, whether it be shopping centres or codes or oil companies or whatever, is a very small business against a very large business and there appears to be a very strong prohibition, either commercially or in other forms, for people to actually act jointly. We come across that in a number of ways, in contracts and so on. That would seem to be absolutely anti-competitive.

Mr Parker—Two questions: firstly, the ability to opt in and opt out. Certainly there is that ability if there are no legal rights which attach to the code. Under the suggestion which we made in our submission of an undertakings process—

Mr ALLAN MORRIS—It does not include that.

Mr Parker—With respect, it does.

Mr ALLAN MORRIS—Which words?

Mr Parker—We have suggested that if one gives an undertaking one simply could not opt out.

Mr ALLAN MORRIS—Which words, because it does not say you have to opt in?

Mr Parker—No, you do not have to opt in.

Mr ALLAN MORRIS—That is right.

Mr Parker—But once you had opted in you could not voluntarily opt out. So the question becomes: what is the necessary incentive to opt in? Those incentives can come about because opting in can give you a marketing advantage. You can present yourself as being a fair trader.

Mr ALLAN MORRIS—Or you can say, 'We are applying for membership for the next three years. We have not quite got there yet but we are going to, so we will observe the code.' That is a real vulnerability, to say that opting in is optional.

Mr Parker—That obviously goes to the very point about whether one has a mandatory code or a voluntary code.

Mr ALLAN MORRIS—No. Yours give some compulsion within the code itself if people are members of the code.

Mr Parker—That is correct.

Mr ALLAN MORRIS—I think that is well worth thinking about. But you do not require them to be members of the code and that is not worth thinking about. That is a real weakness in what you put forward, because once that is there then the opting in will be much different from a code without any teeth to it.

Mr Parker—Are you suggesting that if we went down the undertakings process that there would be less incentive to opt into it?

Mr ALLAN MORRIS—Yes.

Mr Parker—I see your point.

Mr ALLAN MORRIS—Would you accept that?

Mr Parker—Again, it would depend on whether the industry incentives were there for people to opt in.

Mr ALLAN MORRIS—Are you prepared to modify your submission to accept that there should be a stronger code for organisations, that some members of the industry choose not to become part of the industry and have that code apply to it?

Mr Parker—I do not see that we need to modify the submission. I think that is inherent in the submission. We have made the point that the incentive to opt in would be something for the participants. In my earlier comments I made the point that it would be possible to craft onto that a mandatory process whereby industry participants were required to opt in. But, again, that goes back to the question of whether one should have a voluntary or mandatory code. I cannot answer that question in the general, but I can express a general view.

Mr ALLAN MORRIS—I am not being pedantic. The code is one thing, whether it is mandatory or whether it is backed up in the framework that you put forward, which I think has some merit and is worth thinking about. That is quite different from whether an organisation makes itself a formal member of the industry or sits outside it and just looks like it is a member. But that is not the code and not a matter of the code being mandatory, or black-letter law. It is the way the code is projected by those who project it, whether it be government or an agency of some form.

Mr Parker—Sure, and I accept the point that what we are talking about in here is a voluntary process. But within the voluntary process, it would have teeth. The issue of whether the code is mandatory is obviously a further step.

Mr ALLAN MORRIS—And I have a second one about the class action thing.

Mr Parker—This is the question of whether more than one person, say, more than one retail tenant is involved. It is not something that we have addressed in our submission. It is not an issue that I am particularly familiar with in the context of codes.

Mr ALLAN MORRIS—What is you view?

CHAIR—Would you have an official view on that? Would you be able to respond in writing to us?

Mr Parker—We could certainly respond in writing.

CHAIR—I think that would be helpful to us.

Mr ZAMMIT—All the evidence we have received as a committee indicates that voluntary codes do not work. I should speak about myself but, having spoken to some of our colleagues, the general feeling is that as local members of parliament everyone tells us that voluntary codes do not work and they quote many examples as to how they do not work. What surprises me is that your submission seems to place a lot of emphasis on voluntary codes. Mr Beddall, of course, asked you to state one industry where they work. I thought that you would rattle off at least 10 or 12 to surprise us all but you did not do that and, in fact, you could not even draw one example where they were working well. Yet your submission places such strong emphasis on voluntary codes. What empirical evidence did you use to arrive at that point of view?

Mr Parker—The general approach in the submission is one of arguing from first principles. I would accept that there are obvious cases where voluntary codes have not worked in the broad very well. There are other cases where voluntary codes have worked up to a point, and I think that the Oilcode and its dispute resolution mechanism have been quite successful in certain instances. What we have said is that there are some obvious shortcomings in a number of voluntary codes which have failed. Those shortcomings are amenable to improvement and we have made a suggestion in there. The next step in our view is to say that if one had a choice between a voluntary code which might work and a mandatory code which is another name for a government regulation that, as a preference, we would go for the workable voluntary code. But that is the general framework.

Mr BEDDALL—Is not the Oilcode underwritten by legislation? It is not a voluntary code.

Mr ZAMMIT—It is underpinned.

Mr Parker—It is underpinned by the Petroleum Marketing Franchise Act and, in that sense, there is a default underpinning but the code itself is voluntary. One can opt in and out of that, as I understand it, but that would then simply take you back to the Petroleum Marketing Franchise Act. In that sense, the legislation provides a minimum standard. What the Oilcode does and has done has gone beyond that.

Mr ALLAN MORRIS—It is the old saying: make me pure, but not today!

Mr ZAMMIT—You mention the dispute resolution mechanism. We have heard many examples of dispute resolution mechanisms but the bottom line really is that when it reaches a stage that two sides cannot agree, then what happens? The mechanism is there right across the board. We can quote many examples of these dispute resolution mechanisms being in place, but the bottom line is: what happens when the two sides do not agree? The ones with the power and the money can say 'Let us go to court.' Those who have not got the power or the money invariably say, 'I cannot. I have not got the money. You win.' You have not given us any hope as to the way you think we should be handling the problem. You have given us very—

Mr Parker—With respect, I think that we have. The code based mechanism provides the means by which, pursuant to the undertaking, persons could be bound by the dispute resolution, and if they then walked away from it, there would be a breach of the undertaking actionable in the Federal Court. So, with respect, what we have proposed does and is intended to provide a layer of enforcement under a voluntary code or under a mandatory code, if you built that on—

Mr ZAMMIT—That is subject to the two parties agreeing to be part of the dispute resolution mechanism. What we are saying is: if one party does not want to be part of it, then how do you force that party to be part of it?

Mr Parker—If you have parties to the code, again, it gets back to the issue of the mandatory or voluntary issue.

Mr ZAMMIT—So it just does not work, does it?

CHAIR—Can I come to another topic relating to the banking industry? We have had a lot of evidence before the committee regarding complaints from small businesses in their dealings with banks and finance companies. Some of the problems were that the terms and conditions of finance for small business were misrepresented to the people; banks refused to provide information relevant to the clients' accounts; and there was selective dishonouring of cheques—these are all allegations that have been made in evidence. I just wonder whether you had any thought that the Australian banking ombudsman scheme could be extended to small business, not just those that are unincorporated?

Mr Parker—I can make a number of very general comments, but in terms of answering anything more specific, we will have to take that on notice. The relevant people from our Financial Institutions

Division were not able to be here today. They are bunkered down in pre-Wallis work at the moment. So, I give you their apologies.

My understanding of the banking industry ombudsman scheme is that it can apply to cases of small businesses but only if they are unincorporated, that is, if they are individuals. There is presently a limit, if I understand it correctly, of claims up to $150,000, so that, maybe, it is relatively limited in the case of many small business claims.

There have been in the past a number of suggestions to extend the banking industry ombudsman scheme to small businesses run by corporate entities, but they have not proceeded for a variety of reasons and, if you would like a specific description of the history there, I would prefer to take that one on notice. I would simply note that the Wallis inquiry is imminent and one issue that we would expect the inquiry to handle is, indeed, this very issue. So, we would expect there to be an opportunity for the government to respond to that issue in the not too distant future.

Mr BEDDALL—You might take this on notice: one of the concerns that this committee has is that all businesses are treated the same as BHP; that is, they are perceived to have the same resources. The reality is that there are two levels of business in this country. There are those that are entrepreneurial and have financial growth and are well run. There is a very generic group of businesses in the country that are basically consumers who distribute and sell other products. Yet, the consumers they sell to—the customers—have a lot more protection under the acts than the actual businesses have. Do you perceive that there is a problem in the fact that all businesses treated as business are perceived to have the capacity that BHP or any other large business has, when in fact in many instances they have less resources than the customers that they are serving?

Mr Parker—That is self-evidently a problem. It is a problem in terms of access to justice and to a whole range of things and, indeed, that is one of the reasons the present government is actively pursuing the compliance burden on small business.

Mr BEDDALL—You can get into a debate about compliance. All business has compliance, and that is a competitive pressure, not a pressure from the top down.

Mr Parker—All business has compliance burdens, but larger businesses have a much greater ability to handle a given unit of burden imposed on any business.

Mr BEDDALL—It is a competition issue. If two newsagents have the same compliance burden, then it is not an anti-competitive effect on either of those businesses.

Mr Parker—No, it is not anti-competitive. But there is an equity issue there of the same compliance burden imposed on a small business vis-a-vis a big business. It is precisely the point that you have just made, as to the problem that small business has.

CHAIR—Have you read the evidence that was submitted to this committee by Mr Zumbo, who suggested the repeal of section 51AA of the Trade Practices Act and the amendment of section 51AB to

provide one statutory standard dealing with both commercial and consumer transactions? Do you think there is any reason why the act should contain separate clauses dealing with such conduct in both commercial and consumer transactions?

Mr Parker—I have read a variety of pieces by Mr Zumbo on this point, and another submission to this committee also written in large part by Mr Zumbo. It seems to me that there are basically two threads to the argument. One is a question of whether section 51AA is constitutional. I am obviously not able to give a definitive answer to that question; that is a question for the courts. The argument runs along the lines that section 51AA essentially makes the unwritten law of unconscionability actionable under the Trade Practices Act. It incorporates, by reference, unconscionable conduct law into the Trade Practices Act and provides for a form of remedies.

That raises a question of whether that offends the constitutional doctrine of the separation of powers. There was a recent case—Western Australia v. the Commonwealth in 1995—dealing with the Native Title Act, where the High Court held unconstitutional a provision of that act which said that the common law of Australia in respect of native title has the force of the law of the Commonwealth. That is a somewhat different wording from that in 51AA. Whether the subtlety of that difference is sufficient to lead the court to a different finding, I am unable to say.

But there is a distinction here which could be made between the unconscionable law, as it stands at any particular point in time, and the way that law might evolve.One of the particular concerns with the separation issue is that, because the Trade Practices Act says that unconscionable conduct is actionable, any innovations in the common law or equitable doctrines made by the courts become actionable under the act. In a sense, any judicial activism there feeds through into a law which is actionable under the Trade Practices Act. That seems to me to be a slightly different proposition from, say, a law which incorporated into the Trade Practices Act another body of law, by reference at a particular date.

One possible remedy to any unconstitutional status of this particular law would perhaps be a simple remedy which said that the law of unconscionability could be actioned under the Trade Practices Act, as at a particular date or at some other date set by regulation. That would then require some legislative action, whether in the form of primary legislation or subordinate legislation, to incorporate any judicial innovations. Whether that simple amendment would address any constitutional issues is not for me to say; it is merely a suggestion of something which might be considered.

That is by way of background to the point that Mr Zumbo and others have made, which is that section 51AB ought to be amended. One of the building blocks of that argument is to question the constitutionality of 51AA and to suggest, therefore, amending it and putting it into 51AB in a different form, which is a law essentially to prohibit unconscionable, harsh or oppressive conduct. My comments here essentially go back to my opening comments.

We are particularly uncomfortable with the prospect of a law which would require the courts to examine the substantive content of a contract separate from the context in which that contract was formed. Our view is that that could give rise to considerable uncertainty as to whether any particular contract would be enforceable. That uncertainty is undesirable in a business context and could have the effect, as an

unintended consequence, of making large business less willing to deal with small business. There would be a risk premium, which would flow through into either an unwillingness to deal or higher prices.

Mr BEDDALL—Can I go to that particular point while it is fresh? You quoted Queensland Wire earlier, and the only advantage of Queensland Wire was that it made business aware of the way that it dealt with other businesses, and that brought uncertainty. Business took that into account. Why wouldn't a change like this mean that business would take into account the possibility, before they entered the contract? If you say it would stop big businesses dealing with small businesses, who do they deal with? Who

supplies them?

Mr Parker—What I am talking about here is a change to the incentive structure. I am not saying that all of a sudden all big business will stop dealing with all small business. Some may. Some companies which have the opportunity to vertically integrate may do more things in house: rather than contracting out some function to a small business, it could do the function in house. There is that opportunity, and some large businesses may say they are not prepared to accept the risk that their contract will become unenforceable, and therefore they will do the function in house. That is a possibility.

The other element to that is that markets price risk. That is what markets do. If big business perceives a higher risk in dealing with small business, it is likely that they will seek to shift that risk. That is essentially what those transactions do. They will charge a higher price or give less, or whatever.

Mr BEDDALL—This is again argued as first principle. There is no evidence of any of this.

Mr Parker—That is the way markets work.

Mr BEDDALL—It is?

CHAIR—But markets fail.

Mr BEDDALL—You see that in Victoria today: where you outsource health services or whatever, people start—

Mr ALLAN MORRIS—Or food testing.

Mr BEDDALL—Food testing, and those sorts of things. There is no empirical evidence; it is just theory.

Mr Parker—I think there is a lot of empirical evidence of big business deciding whether to outsource or not, depending on whether it is economic to do so or not. But I am suggesting that a law of this sort could, at the margin, change those incentives.

CHAIR—So that might in fact provide a better balance in the equation?

Mr Parker—What I am suggesting is that it might mean that a small business which was providing services to a big business might find itself without a market at all.

Mr ALLAN MORRIS—Rather than going broke?

Mr Parker—Rather than making a profit; and they may go broke.

Mr ALLAN MORRIS—This may mean that big business is a bit more thoughtful about what it contracts out to small business.

Mr Parker—Indeed.

Mr ALLAN MORRIS—In other words, it may not contract out stuff at below cost or below survivability—which it clearly does now, knowing it is protected.

Mr Parker—I am suggesting that they will be more thoughtful about what they contract out, and they may cease contracting out things which they do contract out now, which makes small business—

Mr ALLAN MORRIS—That may see us driving small business broke. I have no doubt that many larger businesses are aware that the business that they are contracting out is being done below cost because they need the work and, therefore, there is a high chance they will go broke, particularly in the building industry where subbies go broke all the time, and the contractor carries no risk. Even the Commonwealth does that on numerous occasions. In fact I quote my own office fitout, for example, where the price was very cheap but sent a number of people broke.

Mr Parker—If that is a contract freely entered into, a 'harsh and oppressive' law is not going to alter that.

Mr ALLAN MORRIS—Sure.

Mr BEDDALL—It can. If someone says you will take this contract and lose money and if you do not take this contract and lose money, you will not get the next contract. That is harsh and oppressive—very unconscionable—and that happens.

CHAIR—I think we have reached the end of our questioning period.

Mr ALLAN MORRIS—Can I put two questions on notice. There are really two important issues I wanted to raise and they cannot be answered now because of the time. The first one is to do with banking. In terms of banking, one of the concerns I have got is that where banks have brought in receivers at enormous cost, they treat the business as a collateral question rather than a business question. The business is valued by its collateral, in other words by the person's house being mortgaged, rather than the business itself. Nowhere in here do I see any recognition of a business loan being about the business rather than about a property or about collateral. In the system we have, collateral based lending by banks is the underpinning problem of so

many of these complaints and concerns.

The second one, Mr Chairman, is—

CHAIR—What is the first question?

Mr ALLAN MORRIS—I am sorry, Mr Parker, I would have thought it was self-evident. I said it was not in your submission. There is no recognition of it and I would like some observations from Treasury as to the implications of the way banks treat commercial loans to small businesses as collateral based rather than business based. Could you offer any comments: whether or not you agree or disagree and whether there is any indications of it being favourable or otherwise? That is a topic that is not touched on and yet it seems to be at the underpinning of all our complaints about banks.

CHAIR—Is that a question you would be able to respond to?

Mr Parker—Yes.

Mr ALLAN MORRIS—Yes, they could.

CHAIR—Second one, Mr Morris.

Mr ALLAN MORRIS—The second one, Mr Chairman, is to do with shopping centres and competition. It has been put to us a number of times that tenants in shopping centres are not in a competitive environment. They cannot move from spot to spot within the centre, as they could in a strip shopping centre, and it is that lack of a competitive environment which really distorts a lot of the questions. It has been raised in submissions, but it is not touched upon in any of the official submissions from departments. I would be interested in the Treasury's comments as to how you view a shopping centre environment, vis-a-vis competition. Is it a competitive environment? If so, how so? If not, what can be done to ensure that within that environment there was possible competition?

CHAIR—Once again, I ask is that something that you are able to respond to?

Mr Parker—We will try.

CHAIR—I would like to thank you for attending the public hearing and particularly for being able to respond to so many of the questions on the spot. I also thank you for your offer to come back with further information in response to the questions.

Mr Parker—Is there a particular date by which you would want these answers provided?

CHAIR—As soon as possible, I think would be the operative term. We are endeavouring to bring this hearing to a conclusion and I would ask that you would respond as quickly as possible—two weeks if possible, shorter if that can help the secretariat. We are working on a pretty tight timetable. Thank you for your attendance.

[10.13 a.m.]

GARDINI, Mr Robert Charles, c/- Gardini and Co., 33 Canberra Avenue, Manuka, Australian Capital Territory

CHAIR—Thank you, Mr Gardini, for taking time to meet with the committee this morning. I understand that you are appearing in a private capacity. The committee proceedings are recognised as proceedings of parliament and warrant the same respect that proceedings in the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament. The committee prefers that all evidence be given in public but should you at any stage wish to give evidence in private you may ask to do so and the committee will give consideration to your request. You have written a supplementary submission to the committee. Would you care to make any additions or alterations to that submission?

Mr Gardini—No, Mr Chairman.

CHAIR—Would you like to make an opening statement before we commence our questioning?

Mr Gardini—Thank you, Mr Chairman. I would like to thank you and the committee very much for the opportunity to appear today. I would like to read an opening statement and then I would like to comment on some key points made by the Treasury officials in relation to their evidence.

CHAIR—Thank you.

Mr Gardini—Mr Chairman, I appreciate the opportunity to appear before the committee today. I appear in a personal capacity following my resignation as Chairman of the Franchising Code Council in December 1996. My reason for appearing today is to expand on matters contained in my written submission to the committee dated 18 March 1997, which I believe contains a package of measures which, if implemented, will be in the interests of the whole of the franchise sector and, I believe, will also a reflect a balance between opposing views and interests.

You will recall that I appeared before the committee on 4 September 1996 shortly following the federal budget, which had granted full funding for the Franchising Code Council for the 1996-97 financial year but which terminated funding for the council for the financial years 1997-2000. At that hearing I gave in camera evidence to the committee relating to the council's concern that it could not continue to effectively administer the code of practice as a result of the government's decision to terminate the council's funding as at June 1997 and to terminate the deed of agreement between the Commonwealth and the council.

The reason for giving that in camera evidence was to allow every opportunity for the council to negotiate with the government to see if we could reverse that decision or reach some outcome that could ensure the continuation of the council. Despite strenuous efforts by the council to negotiate with the minister to address the council's concerns, these efforts proved fruitless and the council closed its doors on 30

December 1996.

I believe that the franchising sector is entitled to be informed of the circumstances relating to the collapse of the council and accordingly I seek to provide the committee with a copy of all correspondence passing between the council and the minister up to the date of my resignation. I also seek to provide the committee with a copy of a legal advice dated 27 November 1996 from Freehill, Hollingdale & Page. In doing so, I request that the privilege attaching to the committee's deliberations also specifically apply to this correspondence.

CHAIR—Do you want that to remain in camera?

Mr Gardini—No, Mr Chairman, I believe that given that the council was reliant upon public moneys the public interest is served by making that material available.

CHAIR—We would have to take them as exhibits rather than submissions. It is agreed that they be taken by the committee as exhibits.

Mr Gardini—Mr Chairman, I provide the documents with one qualification; that is, the documents are in my possession, but I have had not access to council documents following the date of my resignation. So I give them in the knowledge and belief that they reflect the full correspondence between the council and the minister—

CHAIR—Up until the date of your resignation?

Mr Gardini—Up until the date of my resignation. While there has been some speculation as to the reasons why the council collapsed I wish to make it clear that the council could not continue to trade in circumstances where it was likely to become insolvent. Legal advice provided to the council, and that is the document 27 November 1996 from Freehill, Hollingdale & Page, clearly stated, and I quote:

In other words, there are at this point significant uncertainties about whether the funding of $152,000 in 1997-98 will be forthcoming and significant reasons for the directors not to reach the conclusion that the minister's offer should dispel such grounds as the directors had or a reasonable person would have about contravening section 588G of the Corporations Law by incurring debts to be made in the 1997-98 year.

It also needs to be acknowledged that the termination by the government of the council's funding would result not only in a likely position of insolvency but also was directly linked to the council's exposure to the risk of defamation actions being brought against the council.

The council had raised this issue both with the previous government and with the present government. The council's preferred position was for some limited protection from defamation, particularly in relation to its conduct in naming franchisors removed from the register of compliance. The absence of some qualified privilege protecting the council from defamation actions resulted in the council establishing a reserve of approximately $200,000 to defend such actions, and that was on an ongoing basis as a matter of risk management.

The decision of the government to remove the council's funding also meant that there would not be such a reserve and that, as a result, the council's long-term future would be at risk by any party commencing proceedings against the council at any time. In fact, I understand that it was the threat of legal action, and actual legal action, brought against the council following my resignation that lead to its ultimate demise. In other words, the withdrawal of funding by the government directly led to the prospect of the council becoming insolvent in 1997 and also being exposed to insolvency on an ongoing basis through lack of any financial means to defend defamation or other legal proceedings brought against it.

The committee should also be aware that out of the sum of $648,000 appropriated to the council for the financial year 1996-97, the council was only ever paid the approximate sum of $250,000. My recollection is that the break-up of that payment was approximately $200,000 in about July 1996 and a further sum of $50,000 during the period of several winding up resolutions being considered by the council.

Mr FORREST—I am wondering what this has got to do with Mr Gardini's submission that I have read which is looking forward to how we are going to solve some problems in the future. I am wondering what its relevance is to the submission.

CHAIR—I am about to request Mr Gardini to move on to his comments about his actual submission which was dated 18 March.

Mr ALLAN MORRIS—If Mr Gardini has a written opening statement, perhaps we can accept it as an exhibit. He obviously wishes to put on the record some of the background which is important.

CHAIR—Okay, the committee will accept Mr Gardini's opening statement as a exhibit. Mr Forrest has raised a relevant point and that is to address the questions of the submission which you have put before us. I now ask that that document be made a committee exhibit.

Mr BEDDALL—Can I make a point just for Mr Forrest's interest. Mr Gardini gave evidence to this committee before the winding up of the Franchising Code Council. At that stage it was in camera and much of what Mr Gardini has said now is not new to what has been said that was actually in camera, not on the public record.

Mr ALLAN MORRIS—And that cannot be used in the report.

CHAIR—I think the reason Mr Gardini is before us today is because of his letter of 18 March and that is the matter that we should be addressing, that submission.

Mr Gardini—Yes. It also goes to the issue of voluntariness of a code that is operated out in the marketplace. It goes to the essential features that the council had actually put in its submission to this committee about what would make a successful code of practice. It relates to one of those features being removed which ultimately led to its collapse. I am concerned there is other material on the public record, in the other chamber and in the estimates committee, which puts certain views. I have a different view, a different interpretation about those views, but I do not know whether the committee—

CHAIR—I do not wish to proceed down that track. We have asked you to include that as part of your exhibit.

Mr Gardini—Certainly.

CHAIR—Unless you have some other comment to make about your submission of 18 March, we will proceed to questions.

Mr Gardini—Can I make some comments in my opening statement relating, specifically, to the Treasury and the DSS submissions?

CHAIR—Yes.

Mr Gardini—Which will be a committee document—a part of the record.

CHAIR—It is part of the overall proceedings, and if you wish to address evidence that has been put before the committee, you may proceed.

Mr Gardini—In relation to the Treasury's submission, I would just make a broad comment about this issue of uncertainty. There appears to be an assumption that we are at present in circumstances where there is not a significant level of disputation or litigation in franchising, and that to make any change to legislation would alter the balance and create uncertainty. In that, there is an assumption that it does not recognise the level of disputation and litigation currently going on in franchising. In fact, the level of disputation is much higher than the level of litigation, for the simple reason that many people are denied an effective legal remedy.

In terms of uncertainty, I think it really is, in an economic sense, a zero sum gain. At the present time franchisees, by and large, are losing out in terms of their financial interests. On the other hand, if you make a change to the law which protects those interests—and you have to define those interests—you are really just making a redistribution which corrects some exploitative conduct. So, I think we need to give recognition to that.

In all areas of commerce—and the Trade Practices Act sets out a regime for the regulation of what is essentially prohibited conduct—there is always some level of uncertainty. But that is not to say that the parliament did not accept that it would set out some principles to protect what could only be described as conduct that was not acceptable. The issue, in terms of uncertainty, needs to recognise that that, of itself, is not a reason for rejecting any change.

In one sense, given that the parliament has already said that there should be a law relating to unconscionability, the real issue is whether or not the practical implementation of that law is effective or whether there are significant defects in the operation of that law.

The council was also aware of the view being expressed by some that it was too early to really make a comment on the adequacy of section 51AA so, as part of the council's inquiry into disputation in

franchising, the council sought a legal opinion from Mr Tom Bathurst QC to see whether or not, from an independent perspective, from someone at the bar, the existing provision was adequate in relation to franchising problems.

I have made the suggestion that the committee seek that advice. Mr Bathurst, through an arrangement made—

CHAIR—The committee does have that document.

Mr Gardini—Right. Through an arrangement made through the council and the Australian Competition and Consumer Commission, Mr Bathurst was given access to the ACCC's advisings and legal opinions so that advice could have the benefit of that information, including recent cases such as Ultratune and the Hamilton Island case. In essence, Mr Bathurst has concluded that the existing provision is inadequate to deal with franchising problems.

In terms of the evidence given this morning by Treasury relating to whether codes should be made mandatory, some concern was expressed about the opposition to the Corporations Law suggested approach. As I understand it, there were two basic arguments that the Corporations Law regulates securities and futures markets, not franchising. In response to that I would just point out to the committee that, in fact, the Corporations Law did apply to prescribed interests under the former companies act, and it was only a change which altered that position. That is referred to in my 1994 review.

Also, during my review of the code, the Attorney-General's Department was represented on the steering committee and, at the second meeting of the committee, I put forward that proposal to the committee on the basis that I was going to recommend it in my final report. I then contacted the Attorney-General's Department in the securities area, went through the policy arguments and, essentially, I was led to believe there was no technical legal impediment for a government moving down that path as a practical approach.

The other argument put by Treasury is that franchising is not passive like an investment in securities in the futures industries. In one sense, it is passive. It is passive in the sense—and referring particularly to my submission to the committee—that the nature of franchising is that a franchisee is licensed to operate a business and pays a significant fee for doing that.

Ultimately, the difference between franchising and other businesses is that the franchisee invests his or her capital in the franchise business and the franchisor says, 'You are forgoing all your rights essentially as to how to conduct that business.' The business is conducted in a very tight regime which, based on the previous experience of the system, a franchisee makes a commercial decision whether or not that investment will be successful. Once you invest, it is very similar to investing in the share market. You lose control over the way that money is actually expended, by and large.

In terms of voluntary undertakings in codes, Mr Parker said that a mandatory code would be more resource intensive and would require some institution. If the committee believes—and particularly if it examines the former council's report on disputation and solutions—the evidence, it is very significant that there are a large number of franchising problems, so the question is whether that expenditure is warranted in

the public interest.

You cannot dismiss it on the basis that it will take more resources. In fact, the council had consistently maintained that if the code was effective then it would be much more successful. It would save a significant amount of government funding if the council did not operate, because the council believed it would be a fraction of the amount of public moneys—but that is mere history now.

More ownership was another argument Mr Parker put in support of voluntary codes. You can get a high level of ownership in industry sectors where there are a few players, such as the banking area et cetera, where there is a high level of concentration—the stakeholders would be more united and it is easier for them to talk amongst themselves and say, 'We will go about some self-regulatory regime to fix a problem, be very sincere about that and go about doing that.' However, I think you need to be careful of making general statements about particular codes. The franchising code does not cover an industry. It is a broad-ranging sector from food right across to other areas—the oil industry, motor cars. It is a very loose-knit sector. It is very difficult to get ownership of such a code.

Mr Parker put forward the view that a voluntary code is more adaptable than a mandatory code. I do not necessarily think that that has to follow because if, for example, the franchising code were to be made mandatory, the sector itself has already contributed to what it believes is a code that ought to reflect not best practice but minimum standards.

What you could also do would be to set up some body combining representatives of the franchising sector. Its role would be purely to consult and make comment about the performance of that mandatory code and give that advice to the government of the day. I think that is a way where, under a mandatory regime, you can still consult with the private sector about the content of the code.

Lastly, Mr Parker said that a voluntary code has a better image. I am not so sure about that. A number of franchisees who have suffered significant financial losses would say, 'What about the people who weren't members of the code?' For example, Roger David was a company that was not registered under the code. All that the council could do in those circumstances was to look at the nature of the complaint, pass on some suggestions and indicate that there is a regime for dispute resolution under the code. But it is all very voluntary and, at the end of the day, someone who is not even signed up for minimum standards will, essentially, not be interested in dispute resolution in that context. In terms of a voluntary code having a better image, I think you need to look carefully at all of those who have been impacted, particularly by the lack of effectiveness of the voluntary franchising code.

In terms of section 51AA being unconstitutional, I considered that issue and the council considered it some time ago. The council put its concerns to the Department of Industry, Science and Tourism. That department sought advice from the Attorney-General's Department which indicated that the Attorney-General's Department believed that the provision was constitutional. However, an issue for this committee is whether it is adequate to have some significant constitutional doubt about such a provision and whether, once that provision is in place, some challenge to the High Court would then just be another tactic used.

I think a solution to that issue, even if there is reasonable doubt about it, is for this committee to

consider whether a mere spelling out of the elements of the High Court decision in the Amadio case would remove that constitutional doubt very easily. It may also provide the advantage of the committee considering, depending upon its findings on the evidence submitted to the committee—if the committee moves to extend the operation of section 51AA—whether there is an opportunity to recast the provision in such a way that it deals with problem areas and allows the franchising sector to build on its significant successes. That concludes my opening comment.

CHAIR—Thank you. I draw your attention to the second page of your submission of 18 March. There is the claim that some 25 per cent of franchisors are currently in litigation or major disputation with their franchisees. You say the source of that is the Franchise Council's draft report on franchise disputes. Could you break down that 25 per cent to show those who are in litigation and those who are in, as you describe it, major disputation.

Mr Gardini—Certainly. I will confirm with the committee the precise figure. That figure is taken out of the council's report into disputation in franchising. The figure is taken from an independent survey that the council commissioned of some 600 franchisees and 100 franchisors. The 100 franchisors were used as a cross-checking system. There are some 600 or so franchisors but that number was based on the advice to the council from our consultant. My recollection is that the level of litigation is at the 10 or 12 per cent mark and the balance is in serious disputation. I will confirm that for you this afternoon.

CHAIR—What do you see as major disputation?

Mr Gardini—The independent survey that was conducted asked the respondents a number of questions. My general recollection is that serious disputation related to issues that affected the financial welfare of the parties. Respondents had an opportunity to place some weighting on what was meant by 'serious'. That is all set out in that survey. I am not sure whether I referred that report to the committee.

CHAIR—Perhaps you might refer that to us again so that we have an understanding of what people regard as major disputation. That would be a big help.

Mr Gardini—Sure. It was done deliberately because during my review in 1994 a question was asked about disputation but no weighting was put to it. So there was an endeavour to try and put some weighting on that level.

Mr FORREST—Last Monday, Kleins—the jewellery franchising chain—issued a press release saying that any replacement being considered by the council should be funded by the industry involved and they suggested a levy. In their media release, they suggest this might raise between $800,000 and $1 million annually. Would that be sufficient income to any new entity to operate and do its job properly?

Mr Gardini—In terms of funding, I think probably the figure for the council to operate adequately is somewhere between $700,000 and $1 million per annum. To answer your question, in terms of financial resources, it is adequate on the basis that the council is operating on. There has been a significant level of inquiries and disputation. However, in responding in that way, I do not want to mislead you to say that that does not mean that the council would be affected. That would be sufficient funding to enable the council to

operate in the way that it was operating. It would not address the issues of the defamation risk, of informing the marketplace of those who had been removed from the register.

On that point, I believe the council had some 70 investigations running and there were about a dozen or so major ones. That one large franchise company withdrew from registration under the code because the council started to commence audits of disclosure documents. An internal memorandum from that company indicated that that was the reason for it withdrawing from the code. So, essentially, the council was investigating a very serious matter of a company operating across Australia. Its response was to merely withdraw from the code of practice. That seemed to take away any action that the council could take.

All that would be left from a package of measures, if you like, that would be successful or not successful would be to say, 'Okay, that's happened.' We could not actually refer that complaint to the ACCC because of the defamation risk. We would have to refer individual complainants to the ACCC and they would look at whether the conduct constituted misleading or deceptive conduct under section 52, or whether the conduct constituted a breach of section 51AA.

Mr FORREST—So, really, you are saying that a voluntary levy is only a part of what would need to be done. There are all these other changes that your submission goes to a lot of trouble to explain.

Mr Gardini—A voluntary levy is part of the difficulty. Given the cuts in the council's funding, we wanted to see whether the franchising sector really supports the code. If it does, it would seriously look at increasing registration fees for those who believe in it. The response that the council received from the Franchise Association of Australia and New Zealand was that it would not accept an increase in fees. The chairman of FAANZ indicated to me in discussions that they had canvassed that view widely across Australia. Given the serious decline, or difficulties, in retailing, they were saying that there is not the money to pay any more.

CHAIR—What do they currently pay?

Mr Gardini—There is a sliding scale with a franchise system, with a maximum of 100 franchisees of $2,000. As part of that, there was the franchisee contribution of $15. But by and large, in discussions with franchisors, basically the franchisors pay that amount because the franchisees essentially go into a franchise system. Despite the efforts to educate the sector about the code, they are there working very hard and very long hours in running their businesses, and, essentially, they do not see it relevant to look at what the code is and what the code can do for them. It is only when problems occur that they then look for assistance.

Mr BEDDALL—I want to go back to some of the things that have been said. The franchising council finished in December, and we have some vague promise that the replacement may appear in about May. My concern is about that length of time. I will get some comment from you about what is happening in the industry at the moment because we really do not seem to have any idea of what is happening with disputes or whatever.

The other concern I have is that there have been a lot of public announcements or protestations that the Franchise Association of Australia and New Zealand is quite keen to run the franchising council. It is sort

of like the fox in charge of the chicken coop. Are you aware of that? Do you think that any sort of mandatory code should include a funding mechanism along the lines that you have suggested—approximately $1,000 per franchisor and then a franchisee fee, which could be collected as each document is signed? The actual mechanism can be quite simple. Therefore, that would obviously provide the franchising council with not only a source of income but also, as the franchising sector expands, an increasing source of income that would enable them to provide further services.

Mr Gardini—I will answer your questions in sequence. What is happening now is very hard to say. I am receiving a number of inquiries from franchisees who have some serious problems and who variously are being looked after by a number of law firms which seem to be charging very high fees. But ultimately there is no solution, because of a lack of effectiveness of 51AA. The exception to that is that, if you are a franchisee in New South Wales, you have the benefit of the Industrial Relations Act.

As to disclosure at the moment, I would very much doubt that franchisors, in respect of offering new franchises, are actually providing disclosure. The code was there. A good proportion of them supported it. Some of them were very sincere in their support and complied with it. But, looking at the quality of those disclosure documents, one would have to say that there was only a small level of compliance with those documents.

What the council was actually trying to do was to raise the quality of those documents, because our audit last year of 150 disclosure documents revealed that only three totally complied with the code. Approximately 30 per cent, you could say, broadly complied and, in relation to that group, the council said, 'Look, you've done that. We have some difficulties in these respects.' We would identify those for the parties and then we would seek that they go away and resubmit a document. And that was to really lift the standards without a big stick. For those who were supportive and wanted to comply that was fine. The fact that there were only about 30 per cent that actually were in substantial compliance left quite a large proportion that were significantly not complying with the code.

Once again we adopted a similar approach with those to say, 'Look, there are major problems here and you really need to go away and produce a document that does comply.' And then through that process a number would not be interested in dealing with or advancing their document. They would just not respond to the council's correspondence, and, ultimately, the council would remove those from the register of compliance towards the end of the year. And that was, I think, one of the greater weaknesses—that we then completed that process and then the council was unable to name them.

Continuing through the features of the code, if there is no disclosure document, I doubt at the moment whether franchisees are being given a cooling off period. In terms of dispute resolution, whilst the council had a process and was developing educational material about that process and developing links with state and territory governments to provide our facilitators to those agencies right across Australia, I must say that the actual use of the process was very small. You are looking at somewhere between 10 and 15 mediations that the council was engaged in.

Most codes have a dispute resolution process in it. As a mediator of some experience as Chairman of the ACT Chapter of LEADR and having been involved in the board of LEADR nationally and on the

Supreme Court panel in New South Wales as a mediator, I can say that you have to have some incentive for both parties to mediate. That really creates the environment where mediation can actually work.

If, as the council found, the franchisee would say, 'We want to have a mediation,' the franchisor would go off and see his or her solicitor, who would say, 'They want to talk, they want to mediate about this,' and essentially the legal advice would come back: 'You can't be sued, so why go along to a meeting where you are going to put your hand in your back pocket and pay someone out?' So, essentially, that was the explanation for the low level of mediations.

In terms of the proposal by FAANZ to run the council, following the budget announcement the council was very concerned as to the future of the code, and I went and had informal discussions with FAANZ to alert them to the fact that this was a very serious issue. I did so on the basis that they could prepare some thoughts, some material, and we could have a discussion about advancing those.

Unfortunately, when I met with FAANZ to discuss all that, FAANZ had met the previous day with the minister and put forward a proposal in concrete without my board having an opportunity to look at it. So all the council could do at that stage was to seek legal advice as to the viability of such a proposal, because it appeared on the face that it breached the code of practice and the memorandum and articles of association of the franchising council. And the advice came back that it would be unlawful for the council to actually entertain the proposal put by FAANZ. So, given that they had, if you like, formalised a process and it was break through or bust, essentially that seemed to be damned.

But, in addition to that, I had real concerns. The role under that proposal was for the council merely to exist as a body to vet the contents of the code, and they would fully administer it. And I just do not believe that you can do that without having an independent body. And to this very day no-one has ever suggested to me—nor have I never seen suggested anywhere else—that the council was not independent. The council was very independent and very united in its views about success of the franchising sector and what policy needed to be put in place for that. And that is contained in the submission that the council has put to the inquiry.

In terms of your last question about a mandatory code: if you are looking to find ways of funding the resource, essentially I do not have any difficulty with making the code not only mandatory—indeed I support that proposal—but also making the funding of that from the sector. Essentially, it is to the benefit of the sector itself that franchising be conducted in a way which does not correct differences in market power but really deals with the problem areas only of exploited or unconscionable conduct. And if such a mandatory body could be funded—in the same way, for example, that the meat industry has similar problems and statutory levies are raised there—I think that is an equitable way. It would mean that that sector itself contributes to it. After all, this sector has been given an opportunity to fund the code, and essentially it was given that opportunity in the most black-and-white circumstances and it walked away from it.

Mr BEDDALL—Mr Chairman, could I put something on the record because there is a good analogy. When I was Minister for Fisheries I was approached by the ocean caught prawn industry, and they approached me about a levy being struck. Because they could not get it voluntarily, the industry totally agreed—

Ms GAMBARO—I dispute that.

Mr BEDDALL—What?

Ms GAMBARO—That the industry totally agreed.

Mr BEDDALL—Two Queenslanders did not agree.

Ms GAMBARO—Come on, David.

Mr BEDDALL—Anyway, the point was—

CHAIR—You are getting into another area there unless you have—

Mr BEDDALL—No, no. It is a direct analogy because what it was there was a levy struck on both the processors and the boats. The opposition of the day agreed and it went through the parliament in a very short space of time. This is not a difficult thing to do.

Ms GAMBARO—Industry support is the thing, and market failure.

CHAIR—I think that particular issue is a matter of some debate.

Mr BEDDALL—But it is not a difficult thing, through the parliament.

CHAIR—It is getting into another area there.

Ms GAMBARO—Mr Gardini, you talked about the fee structure: what percent of those fees did the FCAC get? For example, what sort of fees would a company like Eagle Boys be paying you?

Mr Gardini—I would imagine, because they have developed so well and started off, I understand, in Queensland—and I have met with representatives of the company—they would have, I am very confident, 100 franchisees so they would be paying $2,000—

Ms GAMBARO—To the council?

Mr Gardini—To the council.

Ms GAMBARO—You mentioned you have $200,000 in reserves for possible defamation. What was the state of the books in December last year; the shape of the books of the council? What did you have in your account?

Mr Gardini—I cannot say what it was in December but the administrator's report is on the public record—the Australian Securities Commission. When I resigned on 5 December the council was at the brink of being insolvent. I had two memorandums from the executive director requesting a further meeting to wind

up the council because, although we had cut back significantly from about September last year, the Standards and Compliance Committee could not afford to meet, for example, and a lot of the committees did not continue to meet. Although we had made those cuts, essentially we had an acute liquidity crisis that was addressed by the government granting $50,000 at that time.

Ms GAMBARO—Just one other question: was all of the council in favour of the action that you took in December, or were their other members of the council who had other opinions at the time?

Mr Gardini—There was a variety of views. At that stage, at the first winding up meeting, the majority of directors wanted to wind up the company. That was a mixture of franchisors and franchisees. At the second meeting there was not a majority in favour of winding up, but what had actually muddied the water a little bit at that stage was the proposal that the council could not continue but some other body could. And I think a number of directors believed that there was an opportunity for some other organisation, namely, FAANZ, to take over the role. It became clear at that second winding up meeting that there had been, other than my authority to speak to FAANZ, other directors holding private discussions. So at the end of the day there was some difference of view.

I must say that in the council, in terms of the policy for a successful code, and right throughout my chairmanship virtually up to the solvency issues, there was absolute unanimity of support for what we were doing and what we believed was necessary. The council took the view that the funding for the four-year strategic plan was originally the very minimum amount with which the council could begin to really become effective. As Mr Parker says, if you are going to have a code which is offering market incentives for those who are doing the right thing, then the council has to actually promote those people. That takes an enormous amount of advertising, education and promotion. Essentially with the withdrawal of funding there would not be the ability to achieve what Mr Parker regards as an essential element.

CHAIR—Can I follow up the question from Ms Gambaro about the decision to wind up the franchise council? It was not unanimous. You indicated that to us. Your decision to resign as chairman triggered that off.

Mr Gardini—I do not believe it. Firstly, directors have very serious obligations under the Corporations Law. For my part I had given an enormous contribution of my personal time to seeing that the council was successful.

The council explored, through its accountants, auditors and legal advisers, a number of options which it could look at. Essentially, all those options came back with a view amongst the majority of directors, as reflected at that first meeting, that the council really would not be solvent and would not be able to effectively implement the code. I believe—and this is hypothetical—that if I had not resigned and the council in some way had continued, the council itself was at risk of misleading and deceptive conduct under the Trade Practices Act. That was against a background where the council, in having funding for four years, was able to convince the sector that it was there for the long haul. When it was established in 1993 it was always intended that there would be a review of the code. Franchisors often gave the reason for not joining as, 'The council is not always going to be around.'

Then came my review which created more uncertainty. The sector said it was brought on a little bit prematurely. They were a bit upset about that. Then, essentially, the code was put on a more sure footing for which it really got support from the sector. We moved to a situation where we had funding for one year. My request that the council have a cut in funding over the four years was ignored. Essentially, the council would have been left in a position where it went to the sector saying, 'We are not sure about our future.' What would that do to registration levels, for a start? That was a very serious risk as part of the solvency issue. In addition, the council, in order to get that level of registrations, would have to be virtually pretending to the sector that it would deliver what it had delivered in the last 12 months. I mean, could you go to the sector and say, 'There will be a 30 or 40 per cent reduction in services, but the council is still operating. Will you continue to support the council against a background where the security of the council itself is now in serious doubt?'

CHAIR—Can I just follow another point there. It relates to the $200,000 in that fund. That amount of money would not have been of any great moment if there had been serious defamatory litigation against the council, would it?

Mr Gardini—Not at that stage, but the fundamental point is that, while the council had insurance to cover defamation, insurance only comes into play once litigation has commenced. All the up-front legal fees which are very considerable would have had to have been met out of the council's own moneys.

CHAIR—Did the $200,000 constitute money from the government?

Mr Gardini—No.

CHAIR—Where did the $200,000 come from?

Mr Gardini—The $200,000 was a reserve. The executive director had recommended that that money be put aside out of the subscriptions. There were three tiers of risk management here for defamation. One was qualified privilege for defamation for the council. We did not have that. The second tier, to overcome that risk, was for the minister to name franchisors in parliament. That was not provided. So the council said that in terms of its own risk management procedure it wanted to have a reserve of moneys to be able to defend actions, particularly where the council had to meet the up-front cost and where the council believed that it ultimately would succeed. It was self-insurance.

CHAIR—So you are saying that that $200,000 came from the $15 franchisee fee and the $2,000 franchisor—

Mr Gardini—Correct.

Mr BEDDALL—I think there is some confusion and I want to make sure this is very clear. Mr Gardini, there were two winding up meetings. At the first meeting there was a majority of the board in favour of winding up. Subsequently, there was a meeting between the franchisors association and the minister. Then there was a another board meeting where there was not a majority in favour of winding up. Were the people who changed franchisors? It is obvious some people changed their minds.

Mr Gardini—Yes.

Mr BEDDALL—They were under the impression that the franchisors organisation could take over the running of the council. Is that correct?

Mr Gardini—That was very much the issue running at the time. There was a play by the association in September at the franchising conference in Sydney where the chairman of the franchise association, without any consultation with me, got up and said to that conference of 600 to 800 people that, essentially, there was no need for two bodies. He said, 'We can administer the code. There are some grumblings about what we are paying.'

Essentially, that view did not address the need for independence. It did not really address the very rationale for establishing the code, which was to hand it to the sector and the sector could make up their minds which association they belonged to, whether the AFA in Brisbane, FAANZ, or any other association. That was a matter for them. The question was whether the sector was prepared to fund the code. That was really going to be the test of the code. I think Mr Beddall, in launching the code, made that statement that it is really a challenge now for the sector.

There was a change of mind but negotiations were going on with other parties—

CHAIR—I think that has probably helped the situation. We have probably dwelt enough on the past.

Mr ALLAN MORRIS—Mr Gardini, I liked your example of the stock market and I would go further and say a BHP worker with shares in BHP would be fairly similar to a franchisee. What the Treasurer is suggesting is that there should not be mandatory rules on the Stock Exchange. I find the parallels very striking, actually.

My question is a much more pertinent one at a much lower level. I have been deeply concerned at the lack of franchisee power, and we did question clients in Melbourne about the incapacity of a franchisee to sit in on negotiations about their rent, for example. In other words, the franchisor and the shopping centre negotiate the rent and the franchisee then pays it and any recourse has to be taken through the franchisor. Do you have any observations or comments on that?

Mr Gardini—In terms of business format franchising as a way of doing business, it is acknowledged that the franchisor takes the lease. That seems to be an acknowledged part of it.

Mr ALLAN MORRIS—I accept that.

Mr Gardini—In terms of the negotiations, there were complaints to the council about problems arising in shopping centres. In a sense, there was an overlap between franchising and shopping centres in that way, particularly—the material that came before the council was allegations and we have to test those—when complaints were against the fact that franchisees were often not involved in the negotiations. Often those negotiations were taken in circumstances where even the final agreed figure was actually not reflected in the amount charged to the franchisee. There would be a small number of complaints in that area. They are

essentially locked out from the discussions.

Mr ALLAN MORRIS—Would the code have affected that?

Mr Gardini—That relates to section 12 of the code relating to standards of conduct. The council, if it found a breach, firstly, would investigate. It would endeavour to offer the parties mediation. If that were not accepted and they did not resolve it themselves, the code itself precluded the council from taking any action in relation to a breach of the standards of conduct provisions. The view was put forward when the code was established that the council would not have disciplinary powers in relation to standards of conduct because, supposedly, that was underpinned by section 51AA.

Mr ALLAN MORRIS—Back to square one.

Mr Gardini—Absolutely.

CHAIR—Thank you very much, Mr Gardini, for your attendance this morning, for adding to your submission of 18 March and your additional comments.

Resolved (on motion by Mr Zammit):

That this committee receives as evidence and authorises the publication of the supplementary submission of 18 March received from the Australian Institute of Business Brokers.

Resolved (on motion by Mr Zammit):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

CHAIR—I would like to thank *Hansard*, particularly, this morning. Thank you for your help once again and for the services you have provided to the committee. I now declare the hearing closed.

Committee adjourned at 11.12 a.m.