

# **TAKING COMMERCIAL MEDIATION TO NEW HEIGHTS: MEDIATING FRANCHISE DISPUTES**

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## **ABSTRACT**

The hypothesis of this paper is that franchise dispute mediation requires a higher standard and wider range of mediation skills than most positional bargaining based commercial mediations such as construction dispute mediations.

The inputs that create this higher standard include:

1. power imbalance
2. the financial desperation of franchisees
3. the impracticability of litigation/arbitration
4. inability to afford advice and/or representation at the mediation
5. disappointment and loss of trust in the franchisor/franchisee
6. personal nature of the franchise relationship
7. precedent issues and the effect of 1 dispute on a complete franchise system
8. unmet expectations
9. mediations often involve many franchisee parties
10. selection of franchisees by franchisors
11. business inexperience of franchisees
12. unsophisticated negotiation skills of franchisees
13. the structural nature of a franchise.

The hypothesis will be illustrated from extensive commercial and franchise mediation experience and from the experience of the Office of Mediation Adviser which has appointed mediators for over 430 franchise disputes since 1998 under the Franchising Code of Conduct. Results from feedback from those mediators will be described.

The paper will discuss how mediation of franchise disputes can be more difficult than voluntary commercial mediation because of a mandatory framework such as the Franchising Code of Conduct. The Code is an Australian Government Regulation under the Trade Practices Act which makes it compulsory to attend mediation and try to resolve the dispute if one party requests mediation.

The topic will be discussed in the context of franchise disputes in Australia, Hong Kong, Singapore and New Zealand.

During presentation of the paper a professionally produced 17 minute video of a hypothetical franchise dispute mediation will be shown and discussed.

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## 1. MEDIATION: MANY FORMS IN DIFFERENT CONTEXTS

Let us assume that we are new to mediation and we have no conception of what it is or looks like in operation. Someone invites us to a divorce mediation. Someone else invites us to a mediation involving many community groups. Someone else invites us to a workplace mediation. Then again a multi-million dollar construction dispute mediation. Possibly a dispute over apportionment of a family estate where there is immense hostility. Also a mediation ordered by a court.

What will we see that is different? A co-mediator? No caucuses? Many parties? Limited authority to represent and settle? Many meetings? Involvement of jointly appointed experts to assist the process? Advice or directiveness by the mediator? Mediator with no expertise in the field? Excited participation or technical focus? Control by lawyers? Mediation regulated by statute?

After observing mediation in these different contexts how would we define it? Is it capable of definition?

Many other questions arise. Does a mediator need any mediation training? Should mediation trainers teach a strict model of mediation? Should mediation be taught specifically and differently for use in its particular contexts? Should mediators have a minimum level of expertise in the area of dispute. Should mediation be regulated?

As the mediation profession grows specialisation develops as the number of mediators increases. Initially, mediators are general practitioners mediating in many different areas. Ultimately, parties can choose mediators from a range of many different personalities and areas of expertise. If it is a banking dispute, there will be a mediator who understands banking practice.

What we see with mediation is a process that is as wide in its application as the negotiation process. Each process has its own application in the particular cultural and social context in which it is used. Sugar cane growers in northern Australia have a specific history and set of values in the way they negotiate with sugar mill operators. The same applies to negotiation between contractors on a construction site in Malaysia, employees and employer in a university in Singapore and in every area.

Because mediators are increasingly widely available over time there is a good chance that the mediator will not need to research how disputes are resolved in a particular context because that mediator is likely to have a background in that context anyway.

It is possible that our newcomer to mediation will only come to understand mediation in a particular context and debate definitions of mediation from that point of view with other people who have an entirely different point of view.

Part of that debate will be whether mediation should be therapeutic, facilitative, advisory, directive, determinative or transformative or a combination of these variations.

Therapeutic mediation is a focus on assisting the parties to express their concerns so that they can understand themselves and the other person better.

Facilitative mediation is assisting the parties to conduct the process they choose.

Advisory mediation is where the mediator advises the parties on how to resolve the issues or on what a fair outcome might be or on how a court might decide the matter.

Directive mediation is where the mediator has power to direct the parties to a certain outcome.

Determinative mediation is where the mediator or a delegate has power to decide the outcome.

Transformative mediation is where the mediator assists the parties not only to resolve the issues in dispute but to heal their relationship.

Some may argue that mediation strictly should not include some of the above formats. Some people would prefer to call advisory mediation conciliation. Some people would like mediation to be confined to facilitative mediation.

Consider the following chart as to suitability of the different mediation formats for different types of commercial disputes:

	Therapeutic	Facilitative	Advisory	Directive	Determinative	Transformative
Commercial Construction	1	4	5	5	5	1
Division of family business	3	5	4	4	4	4
Executive employment	3	5	5	5	5	2
Finance disputes	1	4	5	5	5	1
Fitness for purpose of goods supplied	1	4	4	5	5	1
Franchise	3	5	5	3	2	3
Manufacturing licence	1	4	4	4	4	3
Negligent advice	3	5	4	4	5	3
Partnership or shareholders	1	5	5	5	5	3
Product labelling	1	3	5	5	5	1
Sale of Business	1	4	4	4	4	1
Telecommunications	1	3	5	5	5	1

Suitability factors: 1 = low, 5 = high

There may be a combination of elements of any of the mediation formats in any one mediation.

## 2. SKILLS FOR DIFFERENT MEDIATION FORMATS

It is relatively easy to give advice and opinions where the mediator has some expertise in the area. In fact, in mediation training one of the most common comments during the learning process from participants is how difficult it is to refrain from giving advice and opinions. This is especially so in the case of lawyers.

To conduct a facilitative mediation requires a broader range of skills than advisory mediation (see the chart below). Advisory mediation processes are more like a trial where presentations are made to the mediator in the expectation that the mediator will eventually issue a recommendation, perhaps in writing. Where industry or social context gives authority to the mediator that recommendation is tantamount to a binding decision because it is unlikely in practical terms that the recommendation will not be followed. This is particularly the case in many Asian contexts. In courts in China and in some tribunals in Hong Kong even judges will advise parties to settle on certain terms, otherwise they will issue an order in those terms.

An advisory mediator is more likely to focus on legal, moral or community rights and to give advice on what should be done legally or on what is a fair or practical outcome. A facilitative mediator focuses on assisting the parties to understand their needs and objectives and to find solutions that reasonably well meet those needs bearing in mind their other alternatives.

Consider the following chart:

Skills and Behaviours Required for Various Types of Mediation

	Therapeutic	Facilitative	Advisory	Directive	Determinative	Transformative
Accommodating parties' process wishes	3	3	2	1	1	3
Advising	1	1	3	3	3	1
Assisting to set an agenda	2	3	2	2	2	2
Building trust & rapport	3	3	2	1	1	3
Eliciting acknowledgements & apologies	3	3	2	1	1	3
Facilitating parties' understanding & communication	3	3	2	1	1	3
Generating options	2	3	2	1	1	3
Identifying parties' needs & objectives	3	3	2	1	1	3
Keeping parties to agenda	1	3	2	2	2	2
Managing parties' behaviour	3	3	2	2	2	3
Managing the process	3	3	3	3	3	3
Not be dominating	3	3	2	1	1	3
Personal status	1	2	3	3	3	1
Reality testing	3	3	2	1	1	3
Reflective listening	3	3	1	1	1	3
Writing the agreement	1	2	2	2	2	1
TOTAL	39	46	37	29	29	41

Key: 3 = necessary, 2 = relevant, 1 = unnecessary

What can we say is common to all these formats? This is a difficult question to answer, as agreement may not be the goal in the case of therapeutic or transformative mediation. Also, we cannot presume that the mediator will always be an independent and neutral person. Perhaps we can say that in mediation someone is managing a process that has something to do with disagreement or disharmony.

What type of mediation will anyone see when looking at franchise disputes in Australia?

### **3. OFFICE OF MEDIATION ADVISER: RESOLVING FRANCHISE DISPUTES IN AUSTRALIA**

#### **3.1 OMA**

The Office of Mediation Adviser (OMA) has been established by the Australian Government under specific franchise regulation known as the Franchising Code of Conduct. A copy of the Code is available on the small business page of [www.accc.gov.au](http://www.accc.gov.au). Part 4 of the Code relates to disputes.

The OMA's role is to appoint mediators for franchise disputes when asked to do so by one or both of a franchisee or franchisor. If one of those parties requests mediation then the other party must attend and try to resolve the dispute; this is a requirement under the Code. Subject to that requirement the parties are free to use any process they wish to resolve their dispute including litigation.

The Code also requires franchise agreements to include a provision that any party can request mediation of any future dispute.

A franchise dispute is understood to be any dispute related to a franchise agreement between a franchisor and franchisee. A breach of the agreement is not needed before asking for mediation.

The OMA is funded by the Australian Government but there is a charge for the mediation of \$A220 (about \$S190) per hour for the mediator. On average mediations take about 5 hours. The parties each pay half of the cost of the mediator. There is no charge for the administrative services of the OMA.

The Accord Group provides the services of the OMA under a contract with the government.

Parties are free to arrange their own mediator and often do – they do not have to use the services of the OMA. However, there are major advantages in using the OMA's services:

1. Mediators provide their services for a lower cost than they do otherwise
2. The OMA appoints a mediator from a national panel of 110 mediators and there is no delay caused by agreeing on who the mediator should be
3. OMA mediators have an understanding of franchising
4. The OMA conducts quality control review of the mediations that take place.

While there is a definition in the Code of a franchise agreement, there is no definition of what constitutes mediation. There is also no required qualification in the Code for mediators.

Some statutory mediation provisions in Australia require a mediator to issue a certificate that there has been a "satisfactory mediation". No such requirement exists in the Code.

Approximately 75% of OMA mediations are reaching settlement after appointment of the mediator, 14% before the mediation and 61% at the mediation. Settlement is reached at 71% of the mediations. There is no provision in the Code for any other process if the dispute is not resolved at mediation – the parties are left to litigate if they so choose.

The OMA in 5 years has received over 1,300 dispute enquiries and appointed mediators in over 430 of those cases.

#### **3.2 OMA Pre-Mediation Process**

The Code requires that anyone with a dispute should first set out in writing the nature of the dispute and what is required to resolve it. If the dispute has still not been resolved within 3 weeks of that notice then either party may proceed to mediation.

The OMA does not have a role to try to resolve matters before mediation as some mediation or ombudsman schemes do.

After the 3 weeks has passed the parties can agree on their own mediator or ask the OMA to appoint one. The OMA asks for that request to be made in writing.

The OMA will then appoint the mediator and send out the required procedures to the mediator. The mediator will then contact the parties to ascertain some of the facts, to agree on a date and venue, to suggest any preparation that might be helpful, to collect an amount in advance for fees and expenses and to arrange for the signing of the mediator appointment agreement (which is a form required by the OMA). Usually the mediator communicates before the mediation by telephone with the parties although sometimes might meet with them separately.

### **3.3 OMA Mediation Process**

As there is no definition of mediation in the Code, it is left to the OMA to establish the form of mediation for disputes under the Code.

The OMA has established a facilitative model of mediation and has done so in these ways:

1. By requiring applicants for the mediator panel to have undertaken 4 days' mediation training including a satisfactory assessment as a mediator – the OMA considers the type of training undertaken and requires it to be facilitative mediation training
2. By making it clear in the extensive procedures for mediators who are appointed to the panel that facilitative mediation is required – this is a condition of appointment
3. Parties are asked to complete a form after the mediation and one of the questions asked is, “Did the mediator advise you on how to settle the dispute?” So far in over 350 mediations almost no one has answered “yes” to this question.

The distinctive aspects of the OMA's facilitative process are:

1. The mediator refrains from recommending or deciding the solution although the mediator might suggest some options
2. The mediator raises suggestions about how the process is conducted but the decision is made by the parties – this includes matters such as how many caucuses will be held, when they will be held, the agenda items and the order in which they are discussed, breaks, adjournments, ground rules for the parties' behaviour and who will make presentations on behalf of the parties.

While it is important for the mediator to accommodate the parties' wishes, we have seen that the mediators with the highest settlement success rates are professional, organised, positive, enthusiastic and committed to the process. They also tend to have had substantial experience in the corporate or corporate law sector – this means that they have the respect of the parties in terms of being able to take them through their difficulties. It is not enough that the mediators simply chair a settlement discussion; they must be able to assist the parties to close the deal.

### **3.4 Success of OMA Process**

71% settlement success rate for facilitative mediation in the context of a mandatory mediation process is quite high. The respondent party comes to mediation because it is required to do so under the Code. Often it will come quite happily but often it comes under compulsion.

Attendance without active participation is not sufficient – each party must not only attend but also try to resolve the dispute. This means that the parties must seriously consider various options for settlement. It is not acceptable for a party to attend and only make a “take it or leave it” offer.

The settlement rate is also high taking into account the particular difficulties involved in franchise disputes.

For more information on the OMA see [www.mediationadviser.com.au](http://www.mediationadviser.com.au).

#### **4. SPECIAL DIFFICULTIES IN FRANCHISE DISPUTES**

Franchise disputes overall involve a wider range of complexities than the average commercial dispute. Many commercial disputes such as commercial construction disputes involve technical or engineering matters and in the end positional bargaining will determine the final monetary settlement. The mediator usually will know something about the area of dispute and is usually asked by one or both sides for an opinion on the technical or legal aspects. The mediator needs skill in being able to close the gap between the parties’ ascending and descending monetary offers. It is common for the mediator to shuttle from one side to the other with settlement offers.

In commercial disputes it is helpful even necessary to have some subject familiarity in the area of the dispute, for example, engineering expertise in construction disputes.

Franchise disputes not only require the skills applicable to positional bargaining and familiarity with franchising but also require a higher standard and wider range of mediation skills than most commercial disputes because of these factors:

##### *Structural Nature of a Franchise*

A franchise is a system for selling services or a product which is licensed to a franchisee. It usually has a very detailed operations manual which sets out what is required of all franchisees even down to the presentation on the store shelves, uniforms, stationery, logo, opening hours, equipment or ingredients used, range of products sold, signage and advertising. Yes, the franchisee is operating an independent business but it is within very strict parameters to ensure uniformity of the franchise from one franchisee to another.

Some franchisees in time find it difficult to follow the system, sometimes believing they would do better financially if they could vary it. This is particularly the case with franchisees who have been successful in the system – they develop a confidence that they can do even better – it is often these franchisees that a mediator sees come to mediation.

##### *Disappointment and Loss of Trust in the Franchisor*

Franchise disputes are notable for the high level of emotions involved. They are a balance between emotional and financial matters. Being able to deal adequately with financial aspects is important for the mediator but more importantly is the capacity to deal with intangible relationship and emotional aspects.

When a franchisee buys into a franchise it is usually with a lot of trust in the charisma of the person who set up the franchise system. The franchisee follows that person gladly into what they hope is a new and successful future with a proven business format.

It is common after the first few months for the reality of the commitment made to set in. Franchises require hard work, business and financial knowledge and commitment. When things start to prove difficult it is easy for the franchisee to blame the franchisor and believe that the franchisor has failed to keep its initial promises of support and its representations about expected financial performance.

This leads to a communication breakdown but also to a great deal of personal hurt and feelings of betrayal.

### *Personal Nature of the Franchise Relationship*

There is often personal friendship between franchisor and franchisee. They become like an extended family with the other franchisees although franchisees are usually too busy to mix much with other franchisees. Franchisees often feel abandoned by a franchisor once they have paid their franchise fee to buy into the franchise and the initial opening period has passed.

Franchise disputes are resolved after personal issues are dealt with. The mediator must elicit mutual understanding of personal issues and elicit mutual acknowledgements and apologies before the parties start negotiating options. Positional bargaining on the monetary settlement will not be sufficient. Relationship issues must be dealt with first.

In most other types of commercial disputes relationship issues are generally less dominant although it is important that each party understands the contractual issues from each other's point of view.

### *Power Imbalance*

Franchisees are often a husband and wife who have invested a retirement or retrenchment payment into buying into a franchise. They are quite different to the franchisor which might be a sizeable corporate empire.

Often franchisees in dispute are financially distressed – they may have mortgaged their homes to raise extra capital to invest in a failing business. They might be about to lose their homes and other assets. They often cannot afford legal advice or representation. They may have to settle for lower amounts than they may be legally entitled to (although they may not be worse off after taking into account the legal costs to pursue their claim).

On the other hand, a franchisor may be financially strong with access to high standard advice.

Even then, some franchise systems are brought down because of 1 or 2 disgruntled franchisees who can give a franchise system a bad reputation. In Australia, franchisors are required by the Code to issue a disclosure document to prospective franchisees which discloses among other things, details of various types of court proceedings against the franchisor.

### *Impracticability of Litigation or Arbitration*

Because of the costs involved, franchisees often cannot afford litigation despite their strong feelings about the injustice of how they have been treated.

This means that franchisors can assume that franchisees will not take any further action after mediation.

In Australia, government agencies do not provide legal aid for commercial disputants. Government legal action is confined to certain narrow areas usually involving anti-competitive behaviour, a pattern of unconscionable conduct or misleading and deceptive conduct.

Furthermore, it is possible that the amount of the claim means that it is just not worth commencing legal proceedings.

### *Inability to Afford Legal Representation*

It is possible that a franchisee may not settle on fair terms if the franchisee cannot afford legal representation at the mediation. It is important that parties reach agreements on an informed basis wherever possible.

### *Unmet Expectations*

Whether it is misunderstanding, an unrealistic view that the franchise will self-generate income while the franchisee relaxes, hopeful thinking or a lack of understanding or experience as to what running a franchise involves, franchisees often have unrealistic views before going into a franchise. Sometimes, franchisors may not be careful enough about creating expectations as to what income the franchise may create although this decreases with improved maturity in franchising.

### *Selection of Franchisees*

Franchisors may not be careful enough to select the right type of person to be a franchisee. If they are careful enough then this will go a long way to preventing disputes. It is a mistake for the franchisor to just accept anyone as a franchisee who can pay the franchise entry fee.

### *Business Inexperience of Franchisees*

Many people who become franchisees have not had any experience running a small business. They may not know about organising their own accounts, marketing, business planning, negotiation, customer service and employee management.

### *Unsophisticated Negotiation Skills*

Franchisees may not bring well developed negotiation skills to the mediation. A mediator may need to raise options in this type of mediation more than in a commercial mediation with equally experienced negotiators.

### *Multiparty Issues*

Often many franchisees have the same problem with the franchisor and a mediation can be held involving more than one franchisee if the franchisor consents.

Example:

19 franchisees had similar issues in dispute with a franchisor. A mediation took place as follows:

- The mediator met with the lawyer and the two directors of the franchisor.
- The mediator met with the lawyer and the three franchise representatives of the franchisees.
- Four weeks later, the mediator and lawyer for the franchisor met with all 19 franchisees.
- The next day, a mediation meeting took place with the mediator, the lawyers, the two franchisor directors and the three franchisee representatives – the other of the 19 franchisees were in the room and could pass up notes to their representatives but could not speak – every hour the meeting adjourned so the franchisee representatives could meet with the 19 franchisees.
- Agreement was reached after 1 and a half days and the system and business were saved.
- Someone to record the discussion and main agreements on a flipchart assisted the mediator.

Dealing with franchise disputes in a collective way can resolve system-wide problems efficiently and save the time and cost of many individual mediations.

### *Precedent Issues*

It may not be realistic to think in some circumstances that settlements will be kept confidential. A franchisor will be concerned that a settlement with one franchisee may become a precedent so that other franchisees ask for the same deal.

## **5. CONCLUSION**

Franchise disputes by their nature require a higher standard of skill than commercial mediations generally. They do not lend themselves well to a determinative process because of the intangible relationship issues involved.

The success of the OMA process shows that facilitative mediation works well when used in appropriate areas even though most commercial mediation is more advisory or determinative.