

MPs HAVE TAKEN UP THE FIGHT FOR PEOPLE CAUGHT UP IN FRANCHISING

HOOK, LINE AND SINKER



In June 2006 Gerry Hugh was living out of his car, in a basement parking lot. Barely 18 months earlier, he had bought a franchise in a bakery business. After becoming embroiled in an ugly and protracted series of disputes with the franchisor, he lost his house. He also lost his marriage, his health deteriorated, and his business was at the point of collapse.

Mr Hugh's story is not particularly unusual. Others were recounted in the House of Representatives recently when Don Randall (Member for Canning, WA) introduced a motion to recognise the financial stress and hardship faced by franchisees as a result of franchisor misconduct.

Others still were provided in submissions to the Joint Committee on Corporations and Financial Services, which launched an inquiry earlier this year into the Franchising Code of Conduct. The inquiry, which is being chaired by Bernie Ripoll (Member for Oxley, Qld), follows state parliament inquiries in Western Australia and South Australia into the fairness of franchise agreements and the regulatory framework

of franchising. Those reports recommended improved dispute resolution processes and the introduction of specified penalties for breaching the code of conduct.

It's not only the mum and dad franchisees—the Gerry Hughs of the world—whose struggles and frustrations with franchisors have peaked parliamentary interest. Western Australian fast food giant Competitive Foods Australia, which operates a string of KFC franchises, is one of Australia's largest franchisees yet faces the very real prospect of non-renewal of its KFC franchise agreements.

One KFC outlet, in Rockingham (WA), has already been closed after the franchise agreement expired and was not renewed, with the franchisor unprepared to recognise goodwill established over 30 years of operation. The company's owner, Jack Cowin, has made representations to parliament, and both the company and several of its employees have lodged submissions with the Corporations Committee inquiry.

In his motion to the House, Mr Randall argued franchisors should be

AGREEMENTS GONE WRONG.

STORY: JAMES NICHOLSON

held accountable for their unconscionable conduct through a more stringent application of trade practices legislation. He said provisions for mediation at no cost to the franchisee should be considered, noting that many franchisees have inadequate means to redress their grievances without expensive litigation.

“The conduct of rogue franchisors has caused great distress and financial hardship to some of my constituents, and improvements to existing franchising arrangements and regulation are now long overdue,” Mr Randall told the House.

Calling for “a strong bipartisan response” to what he termed “a widespread issue”, Mr Randall said it was up to parliament to seek better protection for franchisees.

“They are out there using their own money in small business to try to make a living for themselves and their families, and they have little or no protection,” he said. “They deserve for this parliament to give them a better outcome.”

Mr Randall cited the example of one of his own constituents, Leanne McCullagh, who had lost her house and was financially destitute after becoming a franchisee.

“There was little if any training provided by the franchisor, and marketing was not as promised,” he told the House. “There then followed verbal abuse and intimidating and thuggish behaviour from master franchisees. The bottom line is that people were forced to walk away from their businesses.”

At the heart of the problem are perceived inadequacies in the provisions of the Franchising Code of Conduct, a mandatory industry code that was established in 1998 under the Trade Practices Act.

The numbers point to an impotent regulatory system and an imperfect relationship between franchisor and franchisee. A recent Franchising Australia survey found 35 per cent of franchisors had been involved in a substantial dispute with a franchisee in the previous 12 months. Meanwhile, in just two and a half years to December 2007, almost 2,000 complaints were made to the Australian Competition and Consumer Commission about franchising matters. Since 1998 the ACCC has undertaken 175 investigations; 108 of them have not been pursued.

Indeed, the ACCC’s capacity to enforce the code of conduct was called into question by Joanna Gash (Member for Gilmore, NSW), who spoke in support of Mr Randall’s motion. She told the House the ACCC had been unable to prosecute any of the cases she had brought to them, and she doubted the cases were investigated as thoroughly as they should have been.

“If the ACCC lacks adequate resources to effectively prosecute its brief then give it the resources it needs,” she said. “But if the ACCC had the resources and cannot even prosecute one case then I would question the competency of that agency.”



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Another central issue raised both in the House and in the inquiry was the alleged practice of ‘churning’, where a franchisor induces the failure of a franchisee for the purpose of buying back the failed operation on the cheap and on-selling it fully priced to a new franchisee.

Steve Irons (Member for Swan, WA) articulated the case of one of his constituents who was forced to sell back his Michel’s Patisserie franchise at a vastly reduced price.

“He has a huge debt to Michel’s because Michel’s continued to trade with him when his business was clearly insolvent. The purpose of that could only have been to drive him into a position where he would have to sell the franchise back to Michel’s for a ‘walk-away’ sum of money and they could then sell the franchise to another potential client. This is known in the business as ‘churning’, an event all franchisors deny happens.”

Mrs Gash takes a very different view to the franchisors. “I am convinced that churning exists and it must be stamped out,” she insisted. “If the Act does not cater for the discouragement of such an immoral practice then it must be amended. If it does then the watchdog is not doing its job. Either way, the government has to act today to restore confidence in this blighted industry.”

Of particular concern to members who spoke on the subject and to those who made submissions to the inquiry was the need to afford reasonable protection to franchisees and to put right the apparent imbalance in the regulatory framework which, in several areas, seems heavily weighted in favour of the franchisor.

Mr Irons suggested that flawed legislation was the reason why the ACCC had been unable to prosecute or pursue any franchisors for the benefit of franchisees, and that successive governments had lacked the political will to change that legislation. He argued for the ACCC to be given sufficient resources and legislative wherewithal to pursue unconscionable conduct by franchisors. Among his other proposals were for franchisees to be refunded if the business model provided by

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franchisors proved to be incorrect, and for a seven-day cooling-off period to be extended. A further suggestion was that, in the event of a dispute, a franchisee should not be closed down until mediation had been concluded.

The motion introduced by Mr Randall went straight to the question of franchisees having inadequate means to redress their grievances without expensive litigation, and that a solution might be the introduction of provisions for mediation at no cost to the franchisee.

It is an issue with which franchisee Nicola Hoy is all too familiar. In March 2006, Ms Hoy, a director of Hoy Mobile Pty Ltd, requested mediation—a request which was refused by the franchisor. The subsequent journey through the legal system took more than two years and cost \$650,000. While the judgment was finally handed down in favour of Hoy Mobile, the franchisor has appealed.

“Until there is a method put in place that can provide affordable and immediate relief, it is near impossible for the average franchisee to enforce their rights under their agreement or under the code,” Ms Hoy said. “The average franchisee is usually five years. The average franchisee is a small business operator with limited resources. Justice is simply out of reach.”

That is a view supported by Malcolm McKellar, a former franchisee who made a submission to the inquiry. “The



franchising code of conduct does not work and will not work as the primary structure of a franchising system,” he argued.

“It has failed those who need it most and will always fail to deliver because it relies on the mechanics of common law and tort for its enforcement. Most franchisees cannot afford to mount a prolonged and complicated legal action to get justice, so in effect they have no recourse to ensure proper conduct of people who have criminal and immoral intent.”

Mr McKellar’s submission recommended the appointment of a franchising ombudsman, the establishment of a franchisor licensing scheme and a requirement for franchisees to belong to a body corporate that would serve the interests of all franchisees within each group.

Another important area in which the franchisee’s bargaining position is significantly weakened is the absence in the code of conduct and legislation of appropriate goodwill or good faith provisions. The issue was brought to the attention of the House and the inquiry.

Current provisions allow for franchisors to deny a franchisee a renewal of the franchise agreement, and further to include in that agreement a clause denying the franchisee any compensation for goodwill.

In the case of the Rockingham KFC restaurant, there was no requirement for the franchisor to compensate Competitive Foods Australia for the goodwill that had been created over 30 years. In a submission to the inquiry, a CFA employee underlined the iniquity of the current provisions.

“How can it be fair and just that a franchisee builds up a successful business through brand equity and recognition only for the franchisor to turn around and say ‘I want a piece of that pie, in fact more than that, the whole pie’,” Shanell Gooch wrote.

“The only way that franchisees can receive some form of protection against franchisor opportunism and abuse of power at renewal is by regulation that applies across the board to set minimum standards of conduct that apply to all franchising relationships.”

A similar suggestion was made to the inquiry by John Rutherford, a director of MRM Pty Ltd, who proposed an amendment to the code of conduct to specifically prevent a franchisor from electing not to renew a franchise agreement, where the franchisor has not provided reasonable compensation to the franchisee for goodwill. The rationale is that any goodwill and income generated by the franchisee will continue to benefit the franchisor.

The Franchise Association of Australia, meanwhile, advocated a seven-point plan, arguing for the inclusion of ‘good faith’ principles in the code of conduct, as well as a requirement for the Australian Securities and Investments Commission to vet franchise agreements, an enforceable code, the appointment of an ombudsman and a revision of the ‘unconscionable conduct’ provision of the Trade Practices Act.

Other suggestions made to the inquiry include better provisions for franchisees in the event of franchisor collapse. Terry Cowan, who was forced to close his store this year after his franchisor went into voluntary administration, proposed better disclosure provisions for franchisors, the termination of franchise agreements in the event of franchise failure, and a provision to afford franchisees the same protection as creditors in such circumstances.

“Franchisees appear to have few rights and little protection in the event of the failure of the franchisor,” Mr Cowan wrote. “Failure of the franchisor should not automatically doom all the franchisees’ businesses to failure as well.”

The committee’s consideration of the respective rights of franchisees and franchisors across a range of circumstances may well find some context in the following definition of that unique relationship, cited by Judi Moylan (Member for Pearce, WA) and borrowed from company owner Jack Cowin: “At the core of the franchise relationship is a belief that franchisees and franchisors will work together in good faith to build a business for their mutual benefit. It is well recognised that this relationship is more like a commercial partnership than a simple supply of services between two parties.”

The committee is due to report in December. •

Further information on the inquiry into the Franchising Code of Conduct is available at www.aph.gov.au/senate/committee/corporations_ctte/franchising or email corporations.joint@aph.gov.au or phone (02) 6277 3583.