Brand Partners
Commercial Lawyers

OUR REF: TO.7710
EMAIL:

8 May 2018

Hon Senator John Williams
144 Byron Street
INVERELL NSW 2360

By Email and Post: senator.williams@aph.gov.au

Dear Senator Williams,

Re: Franchise Sector Inquiry

1. I write to commend you for this long overdue inquiry into the franchise sector.

2. The problems with the franchise sector begin and end with the disclosure document provided by Franchisors to Franchisees.

3. Franchisees are on their knees by the time they realise that the costs of running their franchise far exceed, or bear no resemblance to, what was represented to them in the disclosure document. By the time they realise the real figures are fatally different, the damage has already been done and they have no resources to obtain legal representation and obtain meaningful redress.

4. The mediation procedure under the *Franchising Code* merely delays the Franchisee being able to obtain relief against the Franchisor, all the while the Franchisee continues to haemorrhage money from their business.

5. Breach of an Industry Code gives rise to extraordinary remedies under the *Competition and Consumer Act 2010* (Cth) as was seen in the ground-breaking decision of the Full Court of the Federal Court in *SPAR Licensing Pty Ltd v MIS QLD Pty Ltd* [2014] FCAFC 50[1] (***SPAR Licensing***).

6. In SPAR Licensing, the Full Court set aside the relevant franchise agreement because the figures in the disclosure document were not current. That case was an anomaly because despite the figures in the disclosure document being old, the Franchisee was still profitable.

7. Failing to provide a current disclosure document is a breach of the Code, however, the cost to a Franchisee of establishing the deficiencies in the disclosure document are prohibitive because they often require accounting and legal advice to identify deficiencies. When a Franchisee is failing due to expenses not foreseen in the

[1] http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2014/50.html?context=1;query=SPAR%20Licensing%20v%20MIS;mask_path

disclosure document the onus should be on the Franchisor to prove that the figures contained in a disclosure document have a proper basis.

8. A straightforward alternative dispute resolution procedure should be implemented to enable a Franchisee to obtain an independent ruling whether the disclosure document provided by the Franchisor is compliant with the Code.

Inadequate Disclosure Documents

9. For the purpose of this letter I will describe as an "*inadequate disclosure document*" any disclosure document which is:

   (a) not current;

   (b) inaccurate;

   (c) incomplete; or

   (d) would not enable a prospective franchisee to make an informed decision whether to purchase the franchised business.

10. I have previously acted for a Franchisee against a Franchisor who is one of the major car rental companies. I am not at liberty to discuss the particulars of that case save to say that the Franchisor sold dozens of franchise locations around Australia, many of which the franchisor had operated themselves prior to selling off. The Franchisor did not have adequate procedural systems in place to accurately record, allocate and reconcile the underlying costs of each individual franchise car rental location across the network, even when the relevant location had been operated by the Franchisor for years. The disclosure document in that case bore no resemblance to the real costs of operating the franchise sites. The franchised business constituted by 17 franchise sites which had previously been operated by the Franchisor were insolvent and it was not until our client had operated the business for three years, invested over $6 million and taken out car loans to supply its fleet worth in excess of $60 million (for which the directors gave personal guarantees) did it become apparent that the franchise businesses it purchased was insolvent. This all notwithstanding that the Disclosure Document was drafted by a top tier law firm, who appeared to have little appreciation of what was actually prescribed by the Code.

11. That case was a clear example of the three major issues with the franchise industry in Australia, namely:

   (a) Franchise disclosure documents are not properly policed to ensure their accuracy. It is our strong view that the ACCC should conduct random auditing of disclosure documents and heavily fining non-compliance;

   (b) By the time the Franchisee has identified the undisclosed expenses which are causing the financial distress and should have been included in the disclosure document it is too late; and

(c) Franchisees cannot afford to litigate because of their precarious financial position caused by the deficient disclosure documents leading to business losses and/or failure.

Establishment of a Disclosure Document Adjudication Process

12. In our experience, Franchisees expend at least 30 to 50% of their litigation budget on identifying the deficiency in the disclosure document.

13. If an adjudicative process could be established which requires the Franchisor to satisfy the adjudicator that the disclosure document was compliant and did contain sufficiently accurate information to enable the Franchisee to make a reasonably informed decision about the franchised business, a significant hurdle and expense to Franchisees seeking to vindicate their position could be overcome.

14. The process could be along the following lines:

(a) a Franchisee makes an application for determination which includes the details of its expenditure in operating the franchised business over the relevant period including but not limited to:

i. rent;

ii. marketing;

iii. inventory;

iv. staff costs;

v. equipment purchases;

vi. maintenance costs;

vii. fit-out costs if any; and

viii. upgrade costs.

(b) The Franchisor provides a response which:

i. states whether the Franchisor operated the Franchisee's site before the franchise was sold to the Franchisee;

ii. if the Franchsor did not operate the franchise before selling the franchise to the Franchisee, identifies the five most similar franchises in the franchise network for comparison purposes;

iii. identifies and references where the costs identified by the Franchisee are referred to in the disclosure document;

iv. if the costs are not referred to in the disclosure document, the Franchisee must provide evidence of same costs identified by the Franchisee at the five most similar franchises in the franchise network for comparison purposes.

(c) Once in receipt of the application by the Franchisee and the response from the Franchisor the adjudicator can make a determination whether the disclosure document was compliant with the Code.

(d) If an adjudicator cannot say whether the disclosure document is compliant with the Code or not, they can issue a notice of decision to that effect which confirms whether or not the Franchisor complied in providing a response in the adjudication process.

15. Compliance with the adjudication process should be compulsory for Franchisors under the Code with an applicable civil penalty provision for non-compliance.

16. The above process should be able to be easily complied with by the Franchisor because if they cannot identify and report in relation to the expenses incurred in the day to day operation of their franchises in their network then prima facie the Franchisor does not have the systems in place to provide sufficient information to a prospective franchisee to enable them to make an informed decision and therefore should not be afforded the privilege and trappings of participating in the franchise industry.

17. Further, a decision of an adjudicator that the disclosure document did not comply with the Code would enable a Franchisee to obtain legal advice more easily having had the benefit of the reasons of the adjudicator and would militate attempts by Franchisors to keep the dispute in the mediation jurisdiction to wear down Franchisees with limited or no resources.

Certification and ACCC Approval

18. Lastly, given the potential damage that can be caused by a deficient disclosure document, a disclosure document as a minimum should be accompanied by an audit certification and be lodged with the ACCC for approval.

19. Should you wish to discuss this matter, please do not hesitate to contact the writer on (03) 9602 5800.

Yours faithfully,

TERENCE O'BRIEN
Senior Associate