

10 August 2008

The Chairman
Parliamentary Joint Committee
Inquiry Into Franchising Code of Conduct
PO Box 6100
PARLIAMENT HOUSE, CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Sir/Madam,

Re: Franchising Code of Conduct

The [REDACTED] franchise group entered Voluntary Administration on 30th April 2008. My wife and I were the franchisees of the [REDACTED] Tamworth NSW store at the time. The Administrators sought to sell the Group as a going concern but when they failed to secure a buyer, the chain ceased trading on 26th June 2008. As a result our store closed as at that date and we suffered substantial financial loss, along with the other 120 or so franchisees in the group at the time. This collapse of the [REDACTED] Group has highlighted a number of issues which I believe your Inquiry should consider when reviewing the Code.

The issues are;

1. Inadequate Disclosure provisions
2. Termination of Franchise Agreements in the event of Franchisors failure
3. Franchisees Rights in the event of Franchisors failure

1. Disclosure

Even though it was apparent that in recent times, particularly since interest rates, the cost of petrol and the price of food began to rise that [REDACTED] group sales were suffering, there was no disclosure of the possible impending failure of the group to franchisees. A company does not find itself unable to meet its commitments overnight. I am of the opinion that the Management of the [REDACTED] Group would have been aware of the potential failure of the Group for at least 12 months prior to it occurring.

It is in this context that I believe the Disclosure obligations of the Franchisor under the Code to be inadequate. I suggest that it should be mandatory for Franchisors to provide a financial disclosure document to franchisees on an annual basis and also in the event of a material change in financial circumstances. In the case of [REDACTED] this would have alerted franchisees potentially up to 12 months or more ago that there was an increased risk of failure.

This disclosure needs to be obligatory, as the system where it must be provided upon request relies on the franchisees seeing a need to ask for it. From discussions with other [REDACTED] franchisees, some were sold franchises during the last 12 months, which would suggest there had been some further failure of the disclosure process in its present form.

2. Franchise Agreement

Franchisees appear to have few rights and little protection in the event of the failure of a Franchisor. Franchise Agreements focus on what the franchisees obligations, but in our case it is silent on what the Franchisors obligations are in the event of financial difficulty.

I appreciate that any business venture presents risks including the potential for total loss. However, franchising is very much presented as a way of reducing this risk. Potential franchises are often marketed as “being in business for yourself, but not by yourself”. Potential franchisees are offered supposedly “proven” business systems. I suggest it is fair to state that the majority of new franchisees would acquire a franchise with the belief that it was ‘safe’ business and they would not lose money.

Potential franchisees should be made aware that the Franchisor could fail, and what happens in the event of a Franchisor failure needs to be defined in the Franchise Agreement and in the Franchising Code. Failure of the Franchisor should not automatically doom all the franchisees businesses to failure as well.

Furthermore, the financial failure of the Franchisor should clearly be defined as a breach of the Franchise Agreement and provide an exit opportunity for Franchisees.

If the Franchisor has failed financially, it is no longer effectively capable of meeting its obligations under the Franchise Agreement, and therefore the Agreement should be capable of being terminated at that time.

It is my opinion that the Code should be changes so that in the event of the Franchisor entering Administration the Franchise Agreement can be terminated at the discretion of the franchisee, with a reasonable period, such as 14 days, notice. The protection afforded entities in Administration regarding leased premises should be extended to Franchisees for a sufficient period to enable them to restructure as an independent operator, or alternatively to provide a reasonable period in which to conduct a closing down sale. Landlords should be obligated not to discriminate against former franchisees in this instance. If the business is trading viably and the rent has been paid, the tenant should have the right to continue under the current terms (or better terms if it were negotiable between the parties).

So in summary, in the event of a failure of the Franchisor entity, the Franchise Agreement and the Code should specify that franchisees;

- have the option to terminate the franchise agreement with 14 days notice
- have the right to assume any current lease which may have previously been in the Franchisors name
- have a period of ‘lessee protection’ of up to three months to either move to independent operation or to conduct a closing down sale

3. Franchisee Rights

In the event of the failure of a Franchisor, the Franchisees, as major stakeholders in the franchise system, should be given a specified status in proceedings which are at the very least equivalent to Creditors rights.

In fact, it would not be inequitable that franchisees were given shareholder status, as they all would have made a major investment in the group. Taking that one step further, it would not be unreasonable that, when investing in a franchise, it was structured that the franchisee acquired a small shareholding in the Franchisor entity as part of its franchise fee. The shareholding could be of a class that did not pay dividends, but did allow for access to financial information and possibly even some voting rights. That would make franchising much more the genuine 'partnership' that it is often touted to be. It may also give the franchisee some share in a distribution in the event of the Franchisors failure.

Franchisees are investors, albeit unsecured investors, in the franchisors system, and should have the right to some share of any potential distribution in the event of liquidation of the Franchisor entity. Furthermore, if the disclosure obligations suggested earlier were implemented, a decision to wind up the Franchisor entity may be possible at an earlier point and as such be less financially devastating to all parties.

It should also be incumbent upon Administrators appointed to Franchisor groups to provide frequent detailed reports to Franchisees to enable them to make informed decisions regarding their future.

Thank you for considering my submission. I accept that this will not help the 120 [REDACTED] franchisees who face substantial financial hardship due to the Groups collapse, but I hope that it might assist in avoiding or minimising the impact of it happening again.

Yours sincerely,

Terry Cowan

