PARLIAMENTARY JOINT COMMITTEE
ON CORPORATIONS AND FINANCIAL SERVICES

INQUIRY INTO THE FRANCHISING CODE OF CONDUCT

SUBMISSION

There is no doubt that franchising relationships are open to abuse because franchisors occupy a dominant position within the franchising system, and they have an inordinate level of power in relation to any single franchisee.

This structural power is compounded when the franchisor is a major corporation with access to significant managerial, financial and legal resources far in excess of any franchisee.

Such power is open to abuse in a way that normal competition cannot effectively control.

SUBMITTED BY:
Rodney Hackett
27 August 2008

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1. SUMMARY

1.1 There should be a dedicated Act and appropriate Regulations introduced as soon as possible to deal with the unique nature of franchising, or, at the very least, a more suitable existing Act, other than the *Trade Practices Act* 1974, should be appropriately adapted. Failing this, the *Trade Practices Act* 1974 should be amended to fully address the special relationship between a franchisor and its franchisees. The legislation should:

1.2 Include a comprehensive set of Fair Franchising Standards[1] to establish a proper basis for determining fair and reasonable conduct within a franchising arrangement;

1.3 Include legal sanctions and individual accountability for improper behaviour when a franchisor harms any of its franchisees;

1.4 Regularise the power imbalance between the parties to a franchise to prevent the more powerful from exercising abusive control and harming the vulnerable franchisee;

1.5 Address unfair business practices that can occur within a franchise;

1.6 Include explicit minimum Code of Conduct requirements that impose a duty of good faith and fair dealing; the object being to protect the weaker and more vulnerable franchisees within a franchise relationship from the misuse of power;

1.7 Recognise the special and high level of fiduciary duty which exists between the parties to a franchise agreement;

1.8 Require that franchises include terms obliging the parties to cooperate (with legal sanctions for non-cooperation) - the object being to preserve the broader ultimate win/win business relationship envisaged at the time the agreement was made;

1.9 Require the parties in a franchise to commit themselves to behaving in a way which maintains the good health and mutual profitability of the parties to a franchise arrangement; and

1.10 Create a dedicated Tribunal, or otherwise empower the Federal Magistracy to achieve accessible, straight-forward, and enforceable dispute resolution in franchising matters.

Footnote[1]: see Appendix at page 52

2. OVERVIEW

2.1 Introduction

This is a submission from Rodney Hackett, lawyer, and a past franchisee of two [redacted] Australia Limited [redacted]) restaurants. Mr Hackett supports franchising and endorses the [redacted] "System" and the philosophy of [redacted] founder, [redacted]:

> *The essence of* [redacted] *unique but amazingly simple franchising philosophy, was that a franchising company should not live off the sweat of its franchisees, but should succeed by helping its franchisees succeed ... as equal partners* (John F Love [redacted] - *Behind the* [redacted])

This submission seeks protection for franchisees from unfair practices within the Franchising Industry, especially where there is abuse of the power imbalance which exists within a franchisor/franchisee relationship. The submission addresses the operation of the Franchising Code of Conduct (the Code), and how various anomalies and omissions therein can be taken advantage of by some franchisors to harm and damage their franchisees.

The submission argues the existing Code does not adequately address the imbalance of power and access to resources which exists between the parties to a franchise. This imbalance unfairly, and significantly, advantages the more powerful party when there are competing interests, or the need arises to resolve a dispute between the parties.

The Franchising model itself has some unique relational features. It is not an arms length, business-to-business relationship. It has features paralleling a company and its shareholders, but with nothing like the same level of legal protection currently afforded to shareholders. Even more closely, it resembles a partnership or cooperative, but with nothing like the same level of legal protection currently afforded to partners. Given the dominant position of the franchisor in this special relationship it actually is one that most closely approximates that of the old legal "Master and Servant" relationship.

Yet, again, these franchisee servants, who also make a significant financial investment into the franchising arrangement, receive nothing like the same level of legal protection currently afforded to servants, let alone the significant protection provided to co-investors in other forms of investment arrangements.

The franchisor develops and facilitates the on-going operation of a unique business system/model for its franchisees. The franchisees own and operate the individual business units within the system. In a productive franchising business model, the synergy between the resources invested by the franchisor and those of its franchisees will be better for the respective parties than if each were operating alone. The system should never be utilised to create a win/lose scenario, but rather to create win/win situations.

2.2 The franchise "System"

The nature of the franchise "System" is a key concept. The [redacted] "System" (for example) is defined in the [redacted] franchise agreement as a comprehensive system for the retailing of a limited menu of uniform and quality food products, emphasising prompt and courteous service in a clean and wholesome atmosphere which is intended to be particularly attractive to families.

The foundation and essence of the system is the adherence by franchisees to standards and policies of [redacted], to provide for the uniform operation of all its restaurants.

The "System" within a franchise is not merely the franchisor. The "System" comprises the business operational standards & policies, together with the franchisees and the franchisor. However, and importantly, the franchisor has some interests that are separate from and in conflict with those of its franchisees. For example, the franchisor might own and operate its own stores in direct competition with its franchisees (in the [redacted]s System the stores operated by the franchisor using employee managers and staff, are called [redacted] stores).

2.3 Problems within franchising

The problems within franchising have been brought to the attention of the federal government many times in the past. This Inquiry, like its predecessors, will undoubtedly be appraised of the depth and breadth of these problems.

A case study highlighting some of the more significant issues requiring resolution appears at page 13 of this submission.

The points suggested for development into Fair Franchising Standards, appearing at page 54 of this submission, canvas many more of the issues. It is hoped this Inquiry, and this parliament, will be more effective at dealing with the problems than those previously.

The unique nature of the conceptual issues underlying the troubles within franchising, which are overdue for redress, are overviewed in the following copy letter, which was sent to the government over eight years ago. The problems remain.

[redacted] Family Restaurants

Monday, 28th February 2000

[redacted]
Acting Assistant General Manager
Office of Small Business
GPO Box 9879
CANBERRA ACT 2601

Dear [redacted]

Re: Review of Franchising Code of Conduct.

I refer to your letter to me of 26th November 1999 relating to the above, for which I thank you.

From my knowledge of franchising arrangements, I am aware the difficulties I have experienced as a licensee of the [redacted] Corporation, (which are currently the subject of litigation between us,) are commonplace between licensor and licensee in the marketplace at large.

Let me say at this point however, that I am a proud [redacted] licensee and a great believer in the overall [redacted] system. My dispute with the [redacted] Corporation arose out of what I believe to be an abuse of the relationship between franchisor and franchisee, fuelled by the different interests and objectives of the parties, and at the end of the day the fact there is no Code requiring the parties to clearly spell out all their rights and obligations to each other. As it stands the franchisee is afforded no proper protection from an abuse of power on the part of the franchisor (at the times when their interests compete,) by way of imposing on the franchisor any clear and over-riding duty of care to foster and protect the business of the franchisee (especially against the actions of the franchisor.)

The fact more disputes between franchisor and franchisee do not surface beyond the particular franchise organisation within which they exist is I believe because the franchisee is often unwilling to speak out publicly for fear of further damaging his relationship with the franchisor; and ultimately adversely affecting the value of his own business. Furthermore, there is as yet no effective avenue beyond such organisation for the put-upon franchisee to seek redress; short of instigating full-blown legal proceedings.

If it does nothing else, the Review of the Franchising Code should seek to introduce greater certainty into the relationship between licensor and licensee from the time of its commencement; and address the opportunity which exists for the franchisor to abuse the imbalance of power which inevitably exists between the parties.

I do not believe in over-regulation but I do believe in fair play.

Until the Code is made more effective in achieving this fair play; and in providing a reliable and trusted source of redress, then the risk is the Code together with all the good work done to date will have failed to remedy what I consider to be the greatest difficulties in the field of franchising. We shall then be obliged to continue seeking redress via the court system, which as we know, is not user friendly and is likely to advantage the player with the greater resources.

If I can be of any further assistance in pleading the cause of licensees generally, please do not hesitate to contact me.

Yours faithfully,
Rodney Hackett
[redacted] **Licensee.**

3. THE REGULATION & NATURE OF FRANCHISING

3.1 Current regulation of franchising

Since 1998, following the passing of the *Trade Practices Amendment (Fair Trading) Act* 1998 (the TPA), specific aspects of franchising have been regulated by the Australian Competition and Consumer Commission (ACCC), and the courts. This amendment facilitated small business access to protection against unconscionable conduct. The amendment also allowed industry codes to be prescribed as mandatory or voluntary, and to be enforced under the Act. This later provision resulted in the making of the *Trade Practices (Industry Codes - Franchising) Regulations 1998, which is* the Franchising Code of Conduct (the Code).

The courts have of course had a continuing involvement in resolving franchise disputes through (for example), the doctrine of contract law, and by determining on breaches of the TPA, both prior to and after 1998.

3.2 The nature of franchising

With respect to franchising, the Code provides that a franchise is the rights and obligations that arise from entering into an agreement whereby the franchisor grants to a franchisee the right to carry on the business of offering, supplying or distributing goods or services under a system or marketing plan.

Although the purpose of the Code, in clause 2 (1), is to "regulate the conduct of participants in franchising towards other participants in franchising", the Code does not address all aspects of the franchise relationship.

The Code is mainly concerned with disclosure, certain conditions of agreements, and the resolving of disputes between the franchisor and its franchisees. It does not seek to regulate any misuse of power between the parties.

Parliament has started to regulate the relationship between the franchisor and its franchisees through the provisions of the TPA. However, the TPA should be amended further to provide that the franchising business relationship should be conducted within the obligations of good faith and fair dealing.

The TPA is really an inappropriate Act for dealing with franchising issues. Bringing the issues under the auspices of an existing Act that is more closely aligned to the fundamentals of franchising, such as the Independent Contractors Act is more sensible. Given the unique nature of the relationship, a dedicated Act would be the best that should be done.

4. ABUSE OF POWER WITHIN FRANCHISING & THE NEED FOR REFORM TO THE CODE OF CONDUCT & FRANCHISING LAW

> ***If the relationship is subject to abuse franchisees can then be placed in positions of economic disadvantage by the franchisor.***
>
> Office of Small Business *Discussion Paper*

4.1 Introduction

This section deals with:

- The use or abuse of power by some franchisors to exercise control over, and to damage franchisees; and
- The competing interests within a franchise.

The Commonwealth Office of Small Business (inter alia) in its *Discussion Paper* (way back in December 1999) on the review of the *Franchising Code of Conduct* noted:

Franchising is an inherently unequal relationship. The franchisor is in a position of considerable power, with the ability to determine a range of issues from marketing to product quality and availability. The franchisee, by contrast, does not have this same level of decision-making power. Disparity in bargaining power is not in itself a bad thing, but it can give rise to opportunities for abuse. This potential for abuse is compounded by the fact that, in a franchise system, the franchisee tends to own most of the assets in the individual franchised business, but franchisors retain authority to determine key business and investment decisions. As a result, a franchisee's individual desire to gain a return on investment and develop their business in response to local market conditions may conflict with the franchisor's decisions or plans, which may reflect larger scale considerations that are not synchronised with local market conditions. In such a situation franchisees may find themselves committed to a long-term agreement with high sunk costs, but with no real power to determine their overall cost structure and make strategic business decisions. If the relationship is subject to abuse franchisees can then be placed in positions of economic disadvantage by the franchisor. (page 3)

The 1997 report of the House of Representatives Committee on Industry, Science and Technology *Finding a Balance* noted:

There is no doubt that franchising relationships are open to abuse because franchisors occupy a coordinating position within the franchising system and this provides them

with a significant level of market power in relation to any single franchisee. This structural power is compounded when the franchisor is a major corporation with access to significant managerial, financial and legal resources. Such market power is open to abuse in a way that normal competition cannot effectively control. (page 110)

The parties to a franchise relationship clearly have differing and competing interests and differing levels of power.

4.2 The exercise of control within a franchise

The control exercised by a franchisor (for the purpose of maintaining uniformity and quality) is greater in "System" franchises than in other franchise arrangements. This is because:

- The system franchisee is operating within a proven, unique, comprehensive but constraining business model; and
- The system franchise is more complex and controlled than more limited franchise arrangements, that exist for:-
    - Selling a franchisor's products;
    - Processing or manufacturing wholesale goods using a franchisor's ingredients or formulae; or
    - Trading within a franchise banner as a means of benefiting from group buying and promotional economies of scale.

The power exercised by a franchisor over its franchisees in a "system" is unconstrained by competitive pressure. The system has the appearance of a co-operative relationship but in actuality the interests of the franchisor and the franchisees may be diametrically opposed. There are numerous instances of this. For example, the franchisor is normally able to exert control within the System to change the prices of its products.

Deep and continuous discounting and loss-leadering of products, as opposed to short-term tactical discounting by way of a marketing campaign, benefit the controlling franchisor but are undertaken at the expense of the franchisee. Neither does this activity provide any lasting consumer benefit.

4.2.1 Example One below, demonstrates one aspect of these different interests. In this example, the franchisor's interest is to introduce discounts to expand sales which result in increased fee income for the franchisor. Net profit for the franchisee is however down by 16.8%.

These activities, however, do not fall within existing anti-competitive vertical price restrictions currently prohibited in the TPA; indeed certain loss-leader selling practices appear to be permitted under s 98(2) TPA. These pricing arrangements not only interfere with the market mechanism and substantially lessen competition, but strengthen the controlling franchisor (and its owned and operated businesses).

Example One

Continuous and Deep Discounting Practices Advantage the Franchisor, Not the Franchisee.

1. Base Case without application of a discount

1,000 meals over a period at $5 per meal = $5,000 product sales revenue

(Less) Food costs 1,000 at $2.50 per meal = $2,500

(Less) Other consumable costs = $1,000

Profit after consumables = $1,500 (30% of sales revenue)

Franchise "System" fee = $250 (5% of sales revenue)

Net profit = $1,250

2. Application of 10% discount, with an instant volume increase of 15%, increasing sales to 1,150 meals

1,150 meals at $4.50 = $5,175

(Less) Food costs 1,150 at $2.50 per meal = $2,875

(Less) Other consumable costs = $1,000

Profit after consumables = $1,299 (25% of sales revenue)

Franchise "System" fee = $258.75 (5% of sales revenue)

Net profit = $1,040

Franchisor's revenue has increased by 3.5%

Net profit to the franchisee is however reduced by 16.8%.

Application of the discount increases the franchisor's fee income (from all its franchisees). The example demonstrates the different interests. The franchisor's interest is to introduce discounts to expand sales which result in increased fee income for the franchisor, but at the expense of the franchisee.

4.2.2 Example Two below, demonstrates how a franchisor may also provide discounted products to its franchisee's competitors. In this particular example, the franchisor supplies cheaper fuel to a competitor.

Example Two

Franchisor Provides Discounted Products to Franchisee's Competitors.

An example of a franchisor's behaviour was reported to the Senate Economics References Committee inquiry into the provisions of the *Fair Price and Better Access For All (Petroleum) Bill 1999 and the* practice of multi-site franchising by oil companies. The Committee was advised that franchisees had to:
accept fuel at prices, and on payment terms, dictated by their franchisor oil company while in some cases knowing that their franchisor was supplying cheaper fuel to an independent competitor 'across the road'.

Franchisees, unable to negotiate in relation to the wholesale price, essentially are having their competitive position 'undermined by their business partner, their franchisor, selling fuel more cheaply to their competitors'. (Senate Economics References Committee Report March 2001 Parliamentary Paper No. 41 of 2001)

4.3 Damaging a franchisee within a franchise

Section 46 TPA provides that a "corporation that has a substantial degree of power in a market shall not take advantage of that power" for the purpose of "eliminating or substantially damaging a competitor ...". The High Court has described the object of this section in the following terms:

... the object of s. 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless.

Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away.

*Competitors almost always try to "injure" each other in this way. This competition has never been a tort (see **Keeble v Hickeringill**) and these injuries are the inevitable consequence of the competition s. 46 is designed to foster. In fact, the purpose provisions in s.46(1) are cast in such a way as to prohibit conduct designed to threaten that competition - for example, s 46(1)(c) prohibits a firm with a substantial degree of market power from using that power to deter or prevent a rival from competing in a market. (Mason CJ and Wilson J **Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd** [1989]167 CLR 177, at 191)*

The problems with this provision are that:

- The section appears to condone (under certain circumstances) harmful activities between competitors;
- The TPA recognises, under certain circumstances, the activities of competitors that try to "injure" each other, and that these injuries are "an inevitable consequence of the competition s 46 is designed to foster";
- There is no contravention of this section unless a corporation takes advantage of the power it holds in a market;
- The TPA does not clearly specify any prohibited activities that damage competitors, including unfair and harmful activities that take place within a franchise; and
- The TPA does not consider the effects of these activities, or in many circumstances attempt to limit the harm a franchisor can cause its franchisee.

4.3.1 Example Three highlights this deficiency.

Example Three
A Franchisor Can Adversely Affect the Commercial Interests of its Franchisee.

In ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd*** (2000 VSC 310), Byrne J rejected the submission the franchise contract prevented the franchisor from opening a plethora of competing restaurants in an area contiguous to that of an outlet operated by the plaintiff (Mr Rodney Hackett).

The Judge found [redacted] decision to open the new restaurants was not motivated to apply pressure on the existing franchisee in the area to sell the business or otherwise surrender the franchise licence. (Paragraph 122)

His Honour further found that the contract expressly entitled the franchisor [redacted]) to do acts which may adversely affect the commercial interests of its franchisee. (Paragraph 128)

A distinction needs to be made in instances where there are special relationships between businesses, particularly such as in franchising. This matter was referred to by Byrne J in ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd,*** when His Honour made reference to the case where the impact caused by a franchisor opening a competing business could be such that it "effectively destroys the business" which the impacted operator had negotiated for. (at paragraph 130)

In certain circumstances it would be appropriate for the ACCC (as the law is currently configured under the TPA) to have the power to issue "Cease and Desist Orders" to stop anti-competitive behaviour within a business relationship and before a business is destroyed while the ACCC conducts an investigation.

4.4 Implied terms of a contract - good faith and fair dealing

The TPA should be amended to codify what is being increasingly expressed by the courts, and that is that franchising contracts are deemed to include performance standards of good faith and fair dealing.

This protection, in the form of explicit minimum contract requirements, should be in the form of an amendment to the TPA, imposing a duty of good faith and fair dealing. The object of such an amendment would be to protect the weaker, vulnerable party in a relationship from the misuse of power. Legal sanctions should be provided.

The amendment should require that franchising contracts include terms obliging the parties to co-operate so as to preserve the broader ultimate win/win relationship envisaged at the time the agreement was, or is, made.

The TPA (or other pertinent Act) should oblige the parties in a franchise to commit themselves to behaviour necessary to maintain the good health, and the mutual profitability of the parties. The object of such an amendment would be to discourage business behaviour that is improper, capricious and harmful, or acts that are undertaken for an extraneous, improper purpose, or which have the effect of benefiting the more powerful, at the expense of the weaker party. Legal sanctions should also be provided.

4.5 A case study of abuse within a franchise

Between 1988 and 2007, I was a long term franchisee of two [redacted] Australia Limited [redacted]) restaurants in eastern Melbourne, and had borrowed millions of dollars to meet the required investment needs of the businesses. [redacted] had been a wholly owned subsidiary of its American parent company, but this was soon to change.

[redacted] had always assured its franchisees their relationship was one of a partnership, and they would help make their franchisees successful (for example, see the representations made by [redacted] in the Appendix[1] to this Submission). Yet in the 1990's [redacted] implemented several significant changes which proved contrary to these assurances. Some of these were:-

4.5.1 [redacted] issues shares in the corporation to its officers introducing a conflict of interests - see the following commentary; and extract from the Sun-Herald newspaper of 21 June, 2001:

This article references the belated winding-up of an incentive scheme for corporate officers introduced by [redacted] in the early 1990's. Interestingly, the winding-up occurred soon after the judgment was delivered in the case ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd.***

This incentive scheme handsomely rewarded the officers for the acquisition & development of new stores for the corporation, even where this was clearly at the expense of their franchisee co-investors (through massive corporate cannibalisation of adjacent franchisee's store sales).

This, undeniably, placed the officers in a position of conflicting interests.

The action by the corporation inducing the franchisee to acquire a franchise with one hand, and then blithely taking a large slab of it back with the other, is legally termed a derogation of grant (of the franchise).

There was much evidence to this affect, which had been accumulated prior to the trial of ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd***, but which unfortunately, was not heard by the trial judge.

Such are the vagaries of our legal process.

Footnote[1]: see Appendix at page 50

"Aussie [redacted] take the Money

By SEAN SMITH

Sun-Herald newspaper
21st June 2001

[redacted] Australia has been stripped of Australian ownership after a share buyback, which helped return $80 million to senior managers.

The buyback, plus share purchases by the company's local property subsidiary, soaked up the combined 7 per cent of [redacted] Australia owned by 153 middle and senior managers.

According to [redacted] 2000 accounts, all 3.7 million staff-held shares were bought back by the company or sold to [redacted] Australian Property Corporation for a total $80.2 million.

Most were subsequently cancelled.

The cost of the share purchases implied an average sale price of $21.52 a share, compared to the group's December 1999 valuation of the stock at $18.77.

The biggest winners included chief operating officer [redacted] and fellow director and one-time managing director [redacted] who, with 300,000 shares apiece, would have reaped nearly $6.4 million each.

Current managing director [redacted] realised $3.2 million.

[redacted] spokesman [redacted] said the company's Australian ownership under the 10-year life of the scheme had varied between 7 per cent and 9 per cent.

However, he said the board concluded "there were better ways to provide staff with incentives and maybe it was time to to wind it up".

Details of the buyback surfaced in [redacted] Australia's previously published 2000 financial results, which disclosed a 16 per cent, GST-affected fall in net earnings to $72.91 million.

With about 75 per cent of the Australian chain owned and operated by franchisees, the result reflects the operations of about one quarter of the 700 [redacted] stores in Australia."

4.5.2 A new and overly aggressive site expansion program.

An overly aggressive site expansion program which occasioned new site developments at locations clearly within the primary catchment area (as identified in surveys by [redacted] of established [redacted] franchises was introduced by [redacted] in the 1990's. This resulted in the severe cannibalisation of pre-existing franchisees' store sales, cashflow and profitability; and with a consequentially severe impact on the value of the business, and the franchisees' equity therein.

In response to the concerns of the franchisees on the effect of this policy on their cashflow and the significant financial investment in their stores, [redacted] simply told franchisees that they would have to wear the substantial sales and profit impacts on their individual businesses for the greater interests of [redacted] and its need to grow.

This growth, from the corporate perspective, needed to be maintained, virtually at any cost, to ensure the continued increase in the stock price of the corporation - see the following commentary; and extracts from an article in The Australian newspaper of 22 December, 2001:

> "[redacted] - INSIDE [redacted]
> **The Weekend Australian, Edition 1 SAT 22 DEC 2001, Page 015**
>
> **By: Christopher Dore, Trudy Harris, Mark Whittaker**
>
> It is the world's most recognised brand and Australia's most popular fast-food outlet. The Weekend Australian's Dossier team puts [redacted] under the grill.....
>
> Such is the carefully cultured image of [redacted] consistent, clean and cheap. It has staked a 30-year reputation in Australia on it and has been as successful selling that image as it has been flogging hamburgers.
>
> But in the past couple of years, the sheen has dulled on the [redacted]. The chain's heyday - the mid 1990s, when 145 stores were opened in just two years - has ended and the pot of gold at the foot of those [redacted] has been shrinking. Sales growth has stalled, satisfaction is falling, fascination is at a standstill, the remarkably high market share is under pressure and disaffection among the 480 licensed owner-operators is building.
>
> The GST has also had a dramatic effect. ``When we put prices up 10 per cent," says chairman Peter Ritchie, ``our transactions go down 10 per cent, it's that simple." [redacted] supported the GST but then John Howard ``went and did the dirty on us" by making fresh food exempt.
>
> Only now, chief executive [redacted] says, is the burger giant beginning to recover, moving back into ``5 or 6 per cent growth". ``It was tough, tough going for us." Five years ago, plans were drawn for at least 900 stores to be in place by 2000, but the year finished with the number at just 683.....
>
> On top of that, rather than being a simple hamburger restaurant, it is the world's leading retail landlord - earning most of its profits from collecting rent, not selling food. And in Australia it has had a significant role in formulating government policy - as a key player in GST negotiations and in developing small business laws.....

Although [redacted] is a huge, 100 per cent American-owned organisation, it is run in Australia by hundreds of - usually heavily leveraged - small business men and women who bought franchises to most of the 700 restaurants. [redacted] Australia Ltd, wholly owned by the US parent, owns just one-quarter.

For the franchisees, expansion is a problem as their thin profit margins are eaten away by the [redacted] opened in the adjacent suburb or the nearby mall. Each new store is good for head office, which earns its income through rents and royalties based on gross sales. So what's good for [redacted] - the corporation - is not always good for the franchisees.

Consider how [redacted] makes money. With licensee rents and fees linked to gross sales, volume is crucial. The average customer bill per meal is just $5.60, so there is little room for manoeuvre. Discounting - a favourite technique to drive heavy sales - is good for the corporation but not necessarily good for owner-operators on 5 per cent margins.

``We cannot make anything like a sensible dollar on some meals which are discounted by 30 per cent," one owner says. ``It does increase volume, the gross sales may go up, but it's subsidised by your bottom line."

Many, particularly in the early stages of their 20-year contract, struggle to survive. But when they do start to do well, growing their market, it's in [redacted] interests to bring in a competitor - another [redacted] restaurant nearby - thereby increasing overall sales but lowering profits of franchises.

``In our business the biggest competitor we have is the [redacted] restaurant starting up the street," says Tony Wither, a [redacted] owner for 20 years before he sold out and retired this year.

``It was a concern for a period," says Tagg. ``The rate of expansion was too rapid and I think the company acknowledges that - some of the operators were suffering."

The corporation describes the fallout as ``impacting" but has no formal regime in place for compensation. Yet it is rather belatedly realising that unhappy and frustrated franchisees under serious financial strain are not good for the slick and happy family image.

``They have got to behave ethically towards their co-investors," Victorian owner Rod Hackett says. ``I would say it could be demonstrated that they haven't always done that."

Despite being one of the most successful franchisees in the system, Hackett became so agitated by [redacted] aggressive - but routine - push into his patch that he sued. He lost but the case gave an insight into the methods the food giant employs. What became clear is franchisees that don't toe the line are encouraged to leave. ``When do we f**k Hackett?" uttered a senior [redacted] executive intent on driving Hackett out for complaining about plans to open two new restaurants nearby, the court heard.

The Weekend Australian spoke to other desperate owners. ``There are a lot of guys that are in pain, really in pain ... there are a lot of guys barely making break even." The problem is that everyone is scared of the recriminations if they speak out.....

In the licence agreement with [redacted], franchisees have no geographic boundary protection. It can, without restriction, and does impinge dramatically on its owners by building new outlets. Another franchisee, who sold out after a dozen years, says: [redacted] revenue is made up of a percentage of your sales, so they have no vested interest in making you profitable.

``They do want licensees to actually grow their businesses to the point that they start making about $70,000 a year; anything more than that and they start to think about putting a store near them."

Wither says Hackett ``spoke for a lot of us" who remained silent.

`` [redacted] holds the ace, king, queen and jack, and we've got a two and a four of the wrong suit," Wither says.....

Ritchie says the burger business is tough and the owners have limited room to err: ``It's an extremely fine balance when you are only making a 5 or 6 per cent bottom line, net profit - if you waste too much product you piss that up the wall pretty quickly."

And when the margins are squeezed, the very essence of the [redacted] experience begins to suffer....."

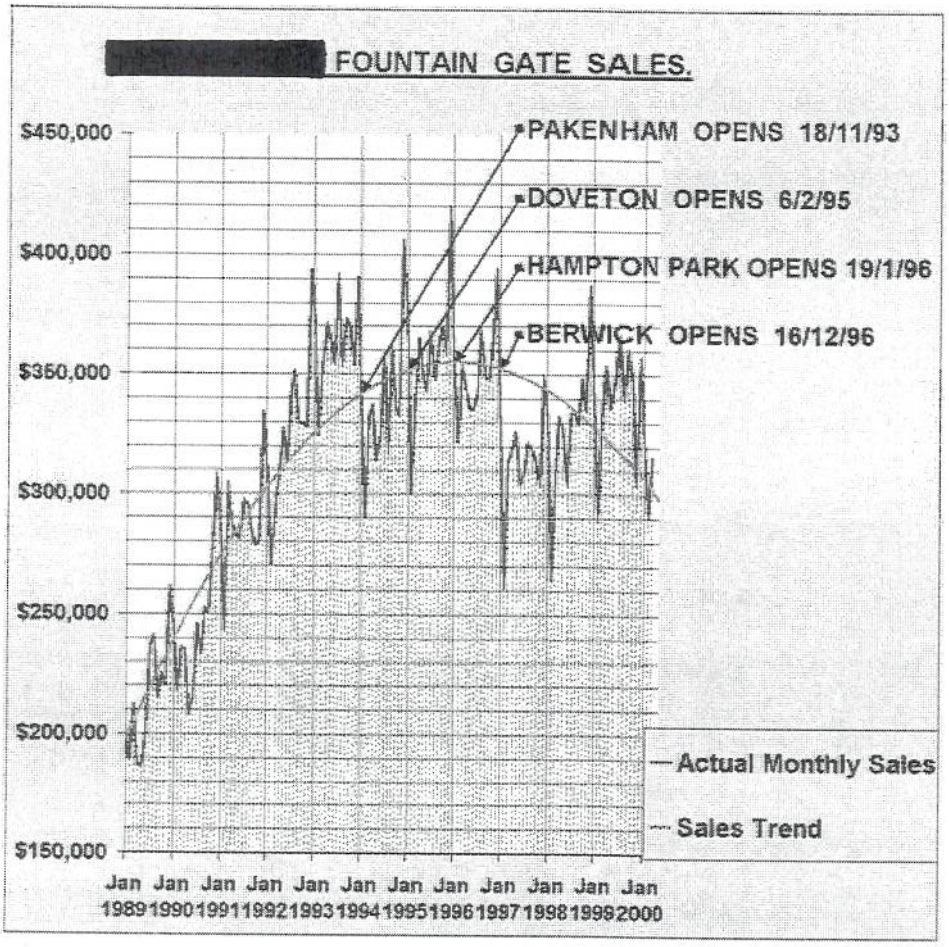
Some Graphic Comparisons

The following two graphs were prepared for the trial of ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd***. Regrettably, my lawyers did not present them in evidence at the trial.

Such are the vagaries of our legal process.

However, you may well find they tell a clear and interesting story about two "partners", in business together.

(a) Graph of monthly sales of impacted franchisee.

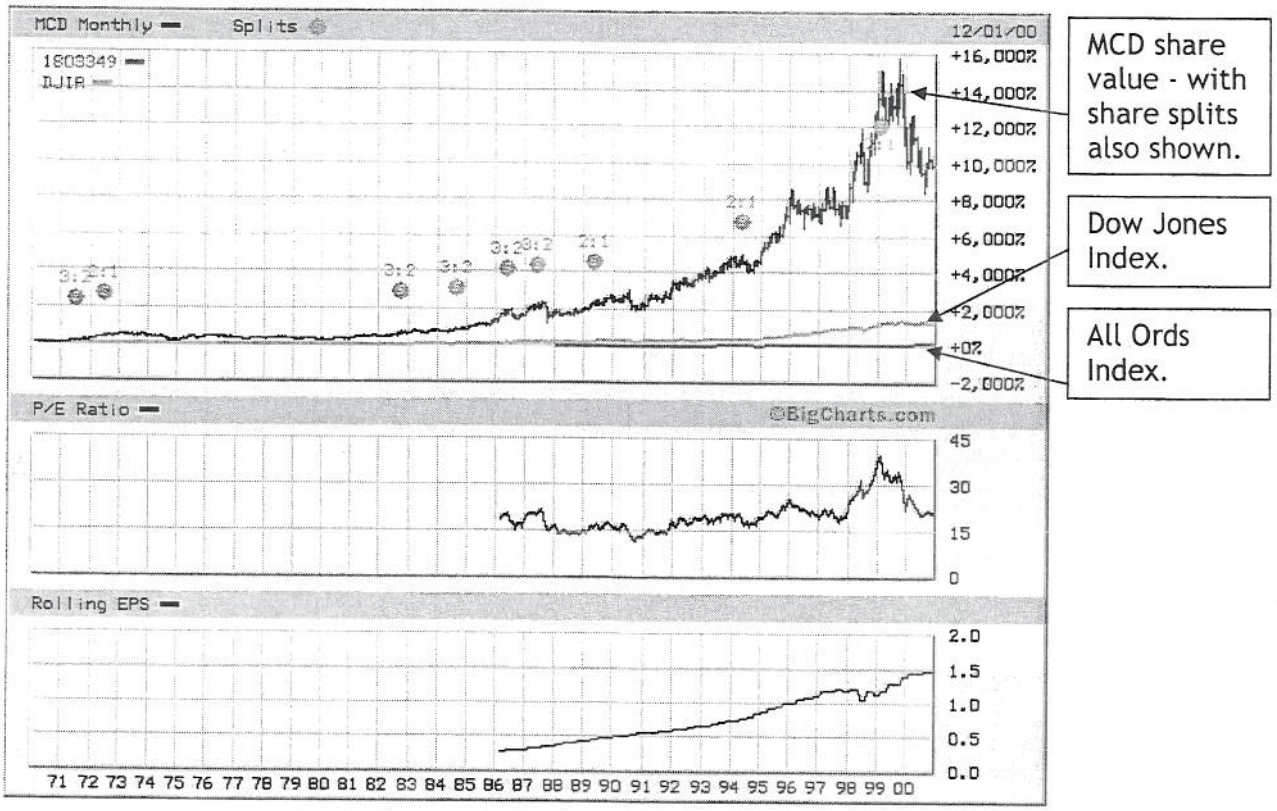


This graph shows the monthly sales of [redacted] Fountain Gate restaurant and the negative impact on the viability of the business resulting from the corporation's cannibalisation policy - cannibalisation being the encroachment on an existing restaurant's primary trading area by a new restaurant.

The graph highlights the dramatic impact on sales, and therefore cashflow and profitability, occasioned by cannibalisation. The negative trend illustrated in the graph would have been seriously worsened if [redacted] had proceeded with the Fountain Gate Shopping Centre store, which was already in its developmental stage in 1996. Only the legal action which I undertook prevented the store from being opened inappropriately at that time.

The graph establishes the way in which the franchisor, intent on pursuing its own business interests, undermines the continuous heavy investment by the franchisee required to build sales.

(b) Graph of [redacted] parent company's extraordinary share growth.



Source: http://www.bigcharts.com/

This graph shows the extraordinary growth of the [redacted] corporation's parent company's share value compared with the Dow Jones Index (brown line) and the Australian All Ordinaries Index (blue line).

This growth is largely the result of the opening of new restaurants around the world.

From the perspective of a fair and equitable franchising arrangement, such franchisor growth should not be at the expense of the individual franchisee's investment in their own small-business.

Also see the following extracts from:-

"Interview With Robert Gottliebsen
[redacted], CEO
5th December 2001

ROBERT GOTTLIEBSEN: [redacted] is 30 years old in Australia. I asked Australian CEO, [redacted], how many stores he now operates and how far has it risen over the decade.

[redacted]: We're having our 30th anniversary this year and we hit 700 restaurants, probably 710 by the end of the year and 10 years ago we were just under 300, so we've doubled the size of the company in the last 10 years.

ROBERT GOTTLIEBSEN: Did you open too many stores during that time?

[redacted]: I think if it was too many we wouldn't be still growing today. We are opening about 30 restaurants still, next year we're planning to open up another 30 restaurants. We probably opened one or two that we made an error on because we really sped it up in the mid-nineties so we learnt some things from that but now our focus is on opening profitable restaurants.....

ROBERT GOTTLIEBSEN: Are the value of Australian franchises rising?

[redacted]: You'll probably have to ask my [redacted] franchisees that. It's not something we report on publicly but I do know that a [redacted] franchise sells more today than what it probably did some 10 years ago but it's still a challenge. You need to increase your turnover and make sure you continually reduce your costs, to make sure the value of your business continues to grow....."

4.5.3 Continuous, deep discounting - see the following commentary by the respected economic expert, Professor Neville Norman:-

The Statement was prepared by Professor Neville Norman, from the University of Melbourne, for the then impending trial of ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd.*** It was obtained by my lawyers as a response to the legal Statements of [redacted], the Chief Financial Officer of [redacted] in Australia.

The Statement of Mr. Jermyn was used at the trial. Unfortunately, Professor Norman's Statement was not. In fact, my lawyers did not call any economist at all, as a witness for the trial, something I considered essential for the running of the case.

Such are the vagaries of our legal process.

Please note the following abbreviations are used: "H" = Rod Hackett; "J" = [redacted]

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Economist Appraisal of the Witness Statement of [redacted]

A. General and Overview Remarks:

1. I am instructed to make independent comments and professional suggestions as an economist in relation to this statement, which is said to be the latest by this deponent. It contains 43 pages (of which the last 3 are by schedule). I do so in the light of detailed reading of other statements, my general and specific professional experience as previously outlined in earlier depositions.

2. J's statement contains many representations of [redacted]) business philosophy, expansion policy, treatment of impact of existing businesses, pricing, dividend, financing, fee etc policies and practices. As a general comment, many of these statements are incomplete, inconsistent or unbalanced or consistent with alternative/ulterior motives or rationale. We elaborate hereunder in a manner that should enable Mr J's propositions to be tested and some of his statements to be exposed as fallible or faulty.

3. Mr J makes several comments on his relationship with Mr H (especially in section 3). I have no comment to make on these other than to say that the surrounding commercial circumstances we otherwise analyse here do not reject the proposition contended by Mr H that he was discriminated against.

4. While Mr J holds himself out as a qualified accountant and finance officer, some of his statistics are unsourced, unclear or erroneous. Some of his references to the position of the economy are not supported by external data.

5. Several of the statements made by Mr J implying that there is a commonality of interests as between [redacted] and the licensees need to be tested. We have devised an independent test which we think discredits many of these statements, which provide a setting for conflict in the light of uneven information and bargaining power as between the franchisees and franchisor.

6. In this statement, all numeral references are to Mr [redacted] latest statement unless stated contrarily.

B. Representation of [redacted] Policies:

7. General: Mr H and other licensees and former senior executives of [redacted] have frequently made reference to the starting days of [redacted] in USA and to the co-operative spirit involving both rights and responsibilities of licensees. Many of the statements of Mr J give only one side of this: the rights. Examples: 2.1.1 total emphasis on licensees toeing the line.

8. Re. Expansion Policy: Mr J gives a passionate case for growing the [redacted] system, supported by statistics of volume growth, store openings and how this is good all round. At 2.3.1 his cites growth from 140 to over 600 restaurants, an increase of over 300%. The case for (unlimited) growth is set out in sections 2.3.1 in a very unbalanced way. But close reflection on the commercial set-up will show why [redacted] will go for growth

even more than their licensees (see the skeleton model later, and what is shows). There is mention of the slowdown in store openings in the middle 1990s (2.3.5) which is said in part to be due to the economy (3.4.2). I have calculated Australian GDP growth, which eased only very slowly in 1996, but remained positive. The data are: y/e 1990/91 0.14%; 1991/2 0.1%; 1992/93 +3.30%; 1993/94 +4.81%; 1994/95 +4.50%; 1995/96 +3.77%; 1996/97 +2.60% (Annual growth in GDP(P), Reserve Bank Bulletin Table G.9) It is much more likely tha[redacted]over-expanded in the quest for the God of Volume (see later) and had to take a breather. Mr J should be questioned upon this to provide a setting consistent with[redacted]penchant for volume expansion even at the expense of the franchisee. By contrast , Mr J says this expansion is in the long-term interests of everyone in the system (2.3.3). This can be doubted. In any event, why did the expansion grind to a halt in 1995, 1996, before fears of an economy slowdown became more general from July 1997 with the Asian economic downturn? More to the point, after all this bragging about expansion and rapid increase in volumes and stores, how can Mr J credibly say that [redacted] has no policy of rapid expansion..? This is at best an inconsistent use of terms, and probably just inconsistent.

9. Re New Store Policy: There are several statements on what[redacted]new store opening policy is, and they are curiously and inconsistently expressed. At 2.3.9 market conditions are emphasized; at 5.1.4 the same, with glib or oblique reference regard may be had to profitability of adjacent restaurants. This statement itself makes plain that rebound effects on fellow licensees is a minor consideration. The truth may be that only the threat and commencement of litigation by Mr H led[redacted]to the position expressed at 4.4.1, in which case the legal expenses should not be removed from Mr H's accounts as Mr J does (at 3.1.6 and schedule at rear). (We have calculated that the removals i.e. pretense that such were extraordinary and should never have been incurred, are $200k, $428K, $236k and $738k for the 4 years to 1999.)

10. Re. Finance: Mr J explains (at section 2.5) the informal (that is, at[redacted]total discretion) finance policy which seems totally at variance with McDonalds trading policy of uniformity and rigidity in relation to logo, menu, operating conditions, cleanliness, etc. Why? What are the reasons the Committee affirmed this policy? None is given at 2.5, indeed the policy was affirmed (2.5.7). J even admits exceptions are frequently made (2.6.3)

11. Re. Dividend participation: Mr J gives a bland account of dividend policy and employee participation (sec. 5.3) , but totally overlooks Mr H's allegations that an entire culture change took place in the mid 1990s in Australia, especially with changes that gave McDonalds more, and its licensees less.

12. Re McDonalds Pricing Policies: By its own admission, [redacted]has a low-price bias, which could deceptively be seen to be a pro-consumer policy. We shall soon show what the real motivation is. First, the documentation. J says with pride, prices have been decreased/restrained in nominal and real terms (5.2.2; 2.3.4) emphasising value (5.2.3)

and part of the essential core strategy. Again, all efforts are made to enable real price reductions over time. (5.2.2). [redacted] has a target of value prices and of restraint, or reduction in real prices over time, to the extent that is sustainable (5.2.3). On my analysis the [redacted] set up is proposition to this low-price bias in an environment in which the interests of [redacted] and the licensees are hotly opposed, not co-operative or similar. See the Model following.

C. A Skeletal Model of [redacted] Pricing:
It seems essential for the proper resolution of this matter that the Court understands the in-built incentives for [redacted] to keep the price as low as possible and to do so against the interests of the licensee. The following model is realistic in that the central components are related to ratios and market circumstances that capture the [redacted] system and current service fee rules and cost conditions. Mr J should be asked to assume the following and to comment upon questions from counsel derived from it.

a. Base case sales of 1000 hamburger meals over a period (like a day or part of a day) at meal price $5. Thus product sales revenue of $5000.
b. Food costs of $2.50 per meal, making $2500 in the trading period.
c. Other consumable costs set at $1000 for the trading period, thus Profits After Consumables at $1500 (or 30% of sales revenue).
d. System Fee of $250, being 5% of sales.
e. An alternative discount situation has a 10% price drop to $4.50 per meal with instant price-elasticity of 1.5 (consistent with [redacted] strategy of not discounting unless sales revenue expands). Volume thus rises to 1150 meals, and food costs from $2500 to $2875. PAC is now $5175 less $2875 less $1000 = $1299 (or 25% of sales).
f. The system fee in the alternative discount situation expands to capture 9% of the entire increase in sales revenue (2.8.5-7), thus to $266, which remains within the 7% cap.
g. The inference is that the licensee receives a sum of $1250 as PAC less system fee in the base case, but only ($1299-$266) $1033 in the price discount scene.

The obvious and compelling inference is that the interests of [redacted] and the licensee are diametrically opposed here. With the discount, [redacted] gets a 6% increase in service fee income and the licensee suffers a 17% cut in income defined as PAC less service fee. This example shows very bluntly why the interests are opposed, why [redacted] has an in-built incentive in this structure to maintain low prices, and why franchisees are disadvantaged.

The above example can be used to make a mockery of some of Mr J's statements, such as: as well as (implying identical interests); (2.4.3) overall interests of the system (ditto); no policy of continuous deep discounts (5.2.1).

D. Statistics:
Mr J cites CPI and wages statistics at 2.3.4. He uses CPI later (2.8.13) to mean the All Groups CPI, but the numbers he uses can only be consistent with the food-only component (see attachment) as the all groups grows 13.4% between 1990 and 1995, food

by 11.25%. However, his "wages" figures are miles out. He says wages increased 7.4% in nominal terms over the same period. Two main series we use for this increased by 19.3% (AWOTE) and 14.5% (AWE) respectively. (Source RBA Bulletin table G.5)(Table G.2 for CPI)

E. Conclusion:
In these and many respects that are several questions for Mr J to answer and a few matters to correct. The central issue is the philosophy of pricing and the scope for the power and information base of [redacted] to operate against licensees. J concedes the information base. It is surely not his role to say what is improper about this; it is for the Court.

NN
15/6/2000"

4.5.4 Intimidation

I became seriously concerned about the impact[1] of [redacted] newly aggressive site expansion plans (underpinned by the new financial incentive arrangements [redacted] had introduced for its officers), and felt I had an important opportunity to raise these concerns around March1995 when the then Federal Government instigated a review of the Franchising Code of Conduct.

Submissions had been invited from interested franchisees and with this in mind I brought this information to the attention of relevant [redacted] franchisees' representatives.

When this information was not passed on to the rest of the franchisee community, I believed it important I notify the other franchisees of the review and encourage their contribution to it.

Subsequently, I was threatened, wher[redacted] (a Regional Director of [redacted]) informed me, "An officer of the corporation has recently said, 'When do we f**k Hackett?' ".

Following this threat, I found my small-business's primary asset (my restaurant at Fountain Gate) under threat by a double impact from [redacted], through it intending to open not one, but two new restaurants nearby (including a food court store only about 400 metres away) - both slated for opening around Christmas 1996.

Footnote[1]: The word "impact" within the [redacted] System is a descriptive term for the cannibalisation of sales and profit occasioned when [redacted] builds another store within the same trading area of another. In the 1990's, during its over-zealous store expansion program, existing stores were suffering impacts of up to 45% of their yearly sales. Such impacts, aside from causing serious cashflow problems, also significantly impact upon the value of a franchisee's equity in their business.

4.5.4.1 Elemental flaw in litigating in Australia

Left with no real alternative, I then unsuccessfully sued [redacted]. The case (including legal, accountancy, expert witness bills, et al) cost me in excess of $3 million, and [redacted] promptly served me with a Bankruptcy Notice for its legal costs of $1.1m - which I only managed to survive, by taking on extraordinary levels of further debt.

The loss of my case against [redacted] is a salutary lesson for us all, and more especially for franchisees. Currently, the legal system is outrageously expensive, tardy and, with Australia (virtually alone in the western world) still retaining the positively mediaeval doctrine of "advocates immunity" - whereby incompetent or negligent advocates cannot be sued for negligence, or the injustices thereby occasioned redressed - certainly cannot be relied upon to produce just outcomes. See the following extract from the article in The Australian newspaper of 14 July 2006:-

> **"Client Wants To See Silk In Court**
> By Chris Merritt, Legal affairs editor
> The Australian newspaper
> 14th July 2006
>
> A disgruntled client of top Melbourne silk Julian Burnside has been told by two lawyers that the Queen's Counsel badly mishandled his case but cannot be sued because barristers are immune from negligence claims.
>
> Mr Burnside, who is one of the nation's most prominent human rights advocates, has been subjected to stinging criticism by fellow Victorian barrister Garry Moore and top Sydney solicitor Bryan Belling over his handling of the case of [redacted] franchisee Rod Hackett.
>
> Mr Hackett unsuccessfully sued [redacted] six years ago over plans to increase the number of McDonald's outlets in a way that could harm his business.
>
> The case cost Mr Hackett $2million in legal bills.
>
> In separate legal opinions, Mr Moore and Mr Belling criticise the way Mr Burnside conducted the case. But they both say Mr Burnside is protected by the legal doctrine that gives barristers and solicitor advocates immunity from the law of negligence.
>
> Mr Moore writes: ``I can readily accept that this matter was mishandled by Mr Burnside QC. He was clearly performing here at a level well below that which could reasonably have been expected of senior counsel of his eminence.
>
> ``Mr Hackett appears to be justified in much of his criticism"
>
> Mr Belling, who is a partner at Sydney law firm Abbott Tout, wrote: ``It seems clear that Mr Burnside QC did not present your evidence in the best light, nor did he adequately cross-examine (the) [redacted] evidence."

Mr Hackett said the existence of barristers' immunity from the law of negligence had prevented him from taking legal action against Mr Burnside....."

4.5.4.2 [redacted] parent company's Charlesworth Region Meeting Minutes

The following copy of the "NOTES FROM DICK ADAMS VISITING MELBOURNE" and "FACE TO FACE" leaflet, deals with a leaked internal document on [redacted] parent company's Charlesworth Region Meeting Minutes. The set of documents, particularly the indicated statements on page 4 of the Minutes, were very important in the running of the trial of ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd*** for they mirrored the complaint made at that time by me and other Australian franchisees on the existence of [redacted] protocols for the removal of licensees through intimidation and causing damage to their business.

Unfortunately, my lawyers forgot to tender this document to the court, until **AFTER** the cases for all the parties had been formally closed. This produced unnecessary and significant problems for the court to accept the document as evidence.

Consequently, the judge, unsurprisingly, disallowed the use of the document as evidence.

Such are the vagaries of our legal process.

PLEASE NOTE:

The following facsimiles of: the ***FACE TO FACE*** newsletter and copy of the [redacted] ***Charlesworth Region Wrap-up*** Minutes, were distributed by Richard Adams (from the Franchise Equity Group & The Consortium) when he was in Australia in November 1996; and the ***NOTES FROM DICK ADAMS VISITING MELBOURNE*** were compiled by David Bayes who attended his presentation as a [redacted] franchisee, on behalf of [redacted]

NOTES FROM DICK ADAMS VISITING MELBOURNE MEETING AT THE HYATT 19 NOVEMBER 1996

FOR LICENSEES

(Document attached)

Present: **5 - 6 [redacted] licensees**
2 "unknowns"
Some [redacted] licensees
Press/lawyers/PR people

Overall comment from [redacted] licensee

- Dick Adams credible
- didn't exaggerate
- 90% of what he presents could be agreed with
- How he presents it - is very good

Adams outlines his background: Franchise Manager, West Coast then franchisee for 3-4 years. Up to 3-4 years ago things in [redacted] were "OK" . Now licensees were desperate - many licensees call him with their concerns and we are heading the same way.
Now as Franchise Consultant - he has an interest in *"stirring up pot".* **Is communications point for dissension.** *"Licensee Union".* **No-one knows who, how many were in the union. His role was to try to bring [redacted] back to the old way - eg the days of [redacted]**

[redacted] now had a short term focus on stock and "f..... licensees" and their equity.The fact that licensees' equity was in danger led to the formation of the Consortium. In '97 there would be a number of legal Issues in US particularly encroachment actions.

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4 December 1996

The 1991 ex-NOAB President (from Little Rock Arkansas) would be litigating one of the cases. Overall there would be a big legal push in the US on impact/encroachment.

He asked why there was no NOAB or Ombusdman in Australia as in the US.

"Operator Equity' would diminish as more stores were built. The whole push of more stores = less equity and loss to licensees.

The legal actions were needed to get the US Company's attention on the loss of equity issue. The US was interested only in the stock price and the Consortium was willing to hurt the Company via the stock price if that was needed to get their attention.

He said they were strong on rhetoric in US - but nothing was being done for licensees. Operators then had nothing to lose so had to fight.

Adams talked of the likelihood of US class- actions in '97.

Basically the day was Rod Hackett driven - he introduced him and asked all the questions. As to what could be done in Australia - form an operators' association preferably NOAB rather than the secret Consortium.

Adams said Franchising 2000 was an 80 page document – a *"Job description for Franchisees".*

He talked of the emerging Australian centralist mentality as being the same as the US Head Office mentality.

Was planning to go to M. UK and Germany. He said rewrites used to be resolved in Year 17 - now it was Year 19. The Company was taking a higher profile in sales -dictating buyers.

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4 December 1996

Everything was short term - not like the days of [redacted] and long term planning.

The situation had gone so far in US with low volume stores that now operators get 2 stores to make themselves viable.

Adams talked of Joint Ventures in US - 50% controlled by Company - yet another method of control by Company.

Back on Stock Price, Adams said the only place for appreciation is from the operators' share not [redacted]. This would mean more rent/royalty and more stores. Ombudsman not trusted anymore. Cooke - OK now - no!
Licensees were getting more stores - but sales and profits were falling.

Adams distributed (attached) a Company memo given out in April which included an internal memo from Charlesworth Region - damning stuff. It said Owner Operators were too rich - how could they hit them. How could they remove operators who failed LOI.

He mentioned Quinlan's personal worth of $51m in stock alone.

Our operator was worried in that every subject discussed, every operator could see some truth in it - eg. growth & loss of equity.
When things went well and the relationship was good - there was trust, but when things bad and no relationship and if no trust, then what?.

Our operator saw 3 fundamental issues flowing to Australia:

1. Store numbers
2. New Licence Agreement - on the one hand if sales were low, operator profits were low;
   and if sales were high, then [redacted] got too much.
3. Communication Issue.

FACE to FACE

A publication for [redacted] franchisees by Consortium Members Inc.

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'April 1996

In preparation for the Annual Shareholder's meeting the company is releasing officers' stock ownership information. Preliminary disclosure shows that [redacted] holds beneficial ownership of 1,582,156 shares of [redacted] stock. Of that amount, 997,500 shares are in option shares.

If the option shares are available for [redacted] to exercise at $25.00 per share (our estimate) and he can sell at $48.00, he nets $22,942,500 by exercising his options.

At the same price, the remaining 584,656 shares he owns free and clear would be worth $28,063,488, giving him a total of $51,005,988 in stock. This total does not include the $5,400,000 [redacted] netted in stock option sales earlier this year.

If you are concerned about [redacted] welfare, send donations to: **Save the Q,** One Hamburgler Drive, Oak Brook, IL.

In the May issue of *Face to Face* we will publish a full report on officers' holdings and compensation.

Mardi Gras - Many members of the Consortium would like to have a get together at the convention but everyone is concerned about anonymity!. Since we will be in New Orleans, a masked ball may be in order. To keep costs under control, we are making the following suggestion: Ski masks with logos can be ordered from Group 11. Ordering information is as follows : Regular – Item #l24657; Large – Item #124658.

How will we know if there are company people in the crowd? They'll be the ones ordering the large size ski masks.

You've had a Windfall - "As you know, as the years go on and the geographic areas evolve, additional [redacted] restaurants will be developed and, as a restaurant opens there may be some alterations in customer behavior. Those customers selecting the new [redacted] do not in any sense 'belong' to the existing restaurant. This merely reflects an ongoing process of market development which is an integral part of the system. Stated another way, when a market can support two or three of our restaurants, the first one built has, in a sense, a windfall until the others are built. The subsequent loss of that windfall is not an impact." [redacted] *Corporation, Senior Vice President*

What will happen at the Convention? Will the company respond to current operator morale? Will they take some shots at the Consortium? Based on recent events, we can be sure the NOAB will be given praise for affecting operator-driven change.

We've suggested you look upon the NOAB and the Consortium as two houses of Congress, the Senate and the House, respectively. Final decisions and action come through the Senate. The House members are more in touch with their constituency, generate more new ideas and, yes, stimulate controversy.

If the Consortium's greatest accomplishment thus far is to give the NOAB more importance and more clout. then we are off to a strong beginning.

A post convention report will be provided in mid-May,. If you would like to report on convention events related to the Consortium, please call (619) 593-6553, or fax your comments to (619) 593-0523.

Franchise 2000, or the plan for years 1995 to 2000, has been closely examined by operators, and a picture of the company's internal plan emerges. Please keep in mind the following is a compilation of operators' projections of the future:

1994 - Internally, Franchise 2000 and the plan for explosive domestic store development are developed concurrently.

1995 - New store development begins impacting existing stores. Since the domestic system is essentially franchised the impact is absorbed by the operators. The combination of impact and menu discounting decreases the value of most domestic franchise stores. Joint ventures begin to proliferate. The year started with 2,750 operators in the U.S. and ends with 2,700.

1996 - New store development continues and existing stores are impacted to the detriment of many operators' financial health. Operators begin leaving the system. Most of the stores sold are acquired by the company through direct purchase or "first option to purchase." A few are converted to McOpCos, but most become joint ventures. The year ends with a domestic total of 2,500 operators.

1997 - Explosive store growth continues and discounting remains a factor due to "hostility in the marketplace." The combination of McOpCos and joint ventures brings the company's control to 35% of the domestic system. Nearly 1,000 stores change hands, three times the yearly average. Impact and discounting have substantially reduced equity. Bargain basement prices prevail. The year ends with 2,350 domestic operators.

1998 - Average store volume has declined substantially and domestic store growth begins to slow as viable locations become rare. There are now only 2,200 operators in the U.S. and the company controls 40% of the stores. Coincidentally, the average store sale brings 40% of sales. Over 1,200 stores change hands.

1999 - With nearly, 15,000 stores in the U.S.. growth slows to 200 stores a year. Operators absorbed the impact of the 90's and find their number diminished to less than 2,000.

2000 - The company's plan, devised in 1995, is successful. [redacted] has been the darling of the stock market through the 90's. The system enters the new millennium with 1,800 domestic operators. The company controls 60% of the stores.

The attached document has received considerable distribution throughout the operator community. Concerning the document's authenticity - the fax header at the top of each page and the *post-it* note on the first page indicate this document was faxed between departments in Oak Brook. The other numbers at the top and bottom are from other various fax machines. Since this is a fax of a fax. some parts are difficult to read. We offer the following partial translation:

On page 2 (top right number)

Under BUSINESS CYCLE (Dave Hamilton)
Barriers: 1) Resistance to change; - O/Os too rich; "Why should I change?"

On page 4 under GENERAL QUESTIONS & ANSWERS-

Q 1: How do we remove O/Os who won't sell after they fail LOI? - Number of avenues available:

- Make an offer to buy at a fair price and stick to it; we don't want to raise the price to get an O/O out
- Make available other O/Os to buy them out
- In your face management; "We don't want you; you are hurting the system", share information with fellow O/Os, don't provide assistance normally available to O/Os
- Even if we can't take a store because the Franchising Agreement won't let us, that doesn't mean it's a blemish on F2K
- People don't want to work with people that don't want them; they *will* leave.
- Greed; "When we grow around you your asset value will diminish over time" due to the impact on an O/O's restaurants.

PLEASE NOTE:
The comments immediately above this box, can be found in the [redacted] Charlesworth Region Meeting Minutes (see **Page 4** of the following copy Minutes.) The red arrows & grey highlighting are mine - R.H.

For Consortium membership information, please call (619) 683-9105 from your fax machine. After following the menu you will immediately receive membership information on your fax. No record is kept of incoming requests.

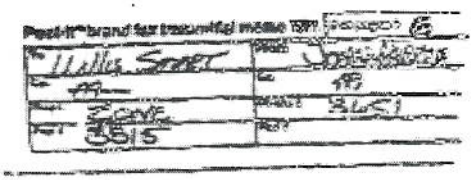
ZONE F2K MEETING

CHARLESWORTH REGION
DALLAS, TEXAS
MAY 1 - 2, 1995

WRAP-UP SESSION

OVERALL
- Don't go back and distrust with Owner/Operators in the Region at this time
- We will have an Overview for all O/Os, and THEN will communicate to the O/Os
- Targeted date to announce to O/Os: MCN in June

REQUESTS
- Keep it internal
- Read, read and re-read the Handbook!



PERFORMANCE CRITERIA (Sandy Thomas)

Barriers & Solutions:
1) Availability of specific measurement tools
   - Market Share
2) Consistency of Business Consultant/FSM/RM/Staff solutions
   - Have agreed upon goals
   - Consistency in the approach we use
   - Entire Regional Staff all understand F2K and speak with same voice
3) Lack of time for Business Consultants and Region: What's our role?
   - Clear communication to O/Os by Region
   - Commitment by RM and FSMs that we support
   - Identify through 1-1-Q what Field Service priorities and goals are

Questions from Orlando Group:
1) How do we better communicate capital reinvestment so O/Os have time to plan, and does it have enough teeth?
2) What does a "history of" mean?
   - Will be subjective
   - Depends on what item we are talking about
   - Some things don't need 3-5 years
   - "History" determined by individual Regions
3) Full time, best efforts: How does it relate to a multiple or a daily base, and what do we mean by "constructive involvement"?
   - O/O needs to be involved in business
4) Does failure to meet Performance Criteria in one area affect a multiple's organization?
   - Yes, it does

5) How do routine visits affect the Scorecard, and are we going to continue to do these?
   - Yes, we will continue to do these routine visits: this will be part of developing history
   - Close to having Compliance Report

BUSINESS CYCLE (Dave Hamilton)

Barriers:
1) Resistance to change
   - O/Os too rich; "Why should I change?"
2) Current knowledge and competencies of O/Os and Consultants
   ***Points related to 1) and 2) above:
   - Whose Plan is it?
   - Communication, understanding
   - Integrity of information
   - History; need consistency – What does this mean?
   - Interdependent elements; need a quality Plan and Scorecard
   - Timing and implementation
3) Balanced Scorecard

Solutions:
- Establish Communication Plan in each Region
- Build a case for change
- Operator leadership involvement
- Determine training needs by Region. THEN execute the Plan
- Develop Scorecard ASAP

- F2K's work is pretty much done, except Scorecard
- Burden is now on Regions to develop an Implementation Plan

REWRITE, GROWTH, REWARDS (James Daughtery)

Barriers:
1) [redacted]
   - How does this really apply t[redacted]?
   - Who is [redacted]?
   - If a store is not rewritable, who does it reach to?
2) Communication / Implementation Plan
   - Need for clarity
   - Target language to O/Os
   - Open, honest communication
   - Limit the phrase "Work in Process"

3) Education & Training
Needed for:
- O/O's in state of rewrite/growth transition
- 2nd generation O/Os
- Business Planning
- Learn more quickly if we have practical examples
- Lack of trust
  - Integrity
  - Competency of Business Consultants, etc.

Solutions:
1) Prior to rollout, clearly define and communicate MoOpCo structure in each Region, *and* how rules will apply
2) Hold internal meeting with staff who are involved in F2K to determine next steps, information needed, resources required, etc.
3) Generate a list of potential situations and associated solutions (case studies, etc.)
4) "Walk the talk"; no deviation!

PROCESS FOR IMPROVEMENT (Larry Zimmerman)

Barriers & Solutions:
1) Communication to O/Os and Region
   - Use O/Os in Communication process
   - Small groups
   - Make an on-going plan, not just a short program
   - Use success stories
2) Education of O/Os and Region
   - Pre-read for O/Os
   - Involve NOAB in process
   - Involve Business Consultants
   - Incorporate Business Planning training in Management & Registered Applicant training
3) Operator resistance to change
   - Explain PFI as a safety net
   - Use face-to-face communication vs. VCN
   - Provide a "face saving" way to leave
4) Consistency of Application
   - Identify MoOpCo Operator to be held accountable
   - Quarterly communication between Regions on "Best Practices"
   - Don't change the program / "work in progress"
   - Avoid "my region is different" (updates to F2K should be done twice a year)
5) Are there enough good O/Os?
   - Strong pool of applicants
   - Long term Franchising Plan for each Region (3 years)

Please Note: The expression "O/O" in the document below, means "Owner/Operator", a synonym for "franchisee". Again, the red arrows are mine - R.H.

6) Consultant workload
   - Redefine job description
   - Retain Consultants
   - Prioritize responsibilities
   - Develop a good Regional Business Plan

GENERAL QUESTIONS & ANSWERS

Q1: How will we remove O/Os who won't sell after they fail LOI?
   - Number of avenues available:
     - Make an offer to buy at a fair price and stick to it; we don't want to raise the price to get an O/O out
     - Make available other O/Os to buy them out
     - "In your face" management; "We don't want you; you are hurting the System", share information with fellow O/Os, don't provide assistance normally available to O/Os
   - Even if we can't take a store because the Franchising Agreement won't let us, that doesn't mean it is a blemish on F2K
   - People don't want to work with people that don't want them; they *will* leave.
   - Grossi; "When we grow around you, your asset value will diminish over time", due to the impact on an O/O's restaurants.

Q2: How will [redacted] be viewed, and how will they grow?
   - Will be viewed the same as franchisees, and use the same system.
   - The responsible person for MeOpCo is where we have to place our decision logic.
   - For the first time, MeOpCo can develop a Plan and execute it; they won't have someone else telling them what to do.

Q3: When will Rewards & Recognition be completed?
   - Putting together models to test in 1996 that range from recognition to trips, etc.
   - Preparing the Business case
   - 1996 will be the year of testing

Q4: Who will judge operations of [redacted] completion of initiatives, etc.?
   - Scamron and Business Consultants work with [redacted] O/Os on food safety; has to be fact-based, driven by customers
   - Will have objective measurements; customer will judge
   - Business Plan will add a lot; will be affected by [redacted] 2000
   - Down the road, Business Consultants will evaluate O/O stores and [redacted] stores

Q5: Software for doing Business Plans: any conversation about making this available to help O/Os?

- Team working to develop I/S Master Plan
- Will look at available software
- Element, methodology may help
- A class available in Region for Business Planning
- Recommendation: look at it to see what type of template we want in our Region
- "Continuous Improvement"

Q6: How will Region share their learning on F2K?

- Have asked Zone Directors, Wiseguys and Franchising Managers to share information between Regions
- Annually, there will be a scheduled time for Top Management and F2K to review F2K (Continuous Improvement)

Q7: Can we get a recap of this meeting?

- Yes

GENERAL ISSUES / FINAL COMMENTS

Consistency Issue
How will it be consistently applied?

- O/O may really be saying, "At O/O in another Region may have an unfair advantage I don't have here."

Implementation Timeline

- General Implementation: phase ins (discussed guideline information sheet)
- Scorecard: plan to have measures ready in 3rd or 4th quarter

Final Comment - John Charlesworth

- Fundamentally, F2K is not going to change; even though there are barriers, we need to design a plan to implement
- "What you see is what we get" -- and it is good stuff!
- Handbook is the "Rules of F2K"; rulings of F2K will be developed over time
- Need to address this positively
- We are responsible for developing the time to the program
- Can use Business Plans to help "clean up" other things on plate

4.5.4.3 Commentaries and Communications

What follow are commentaries originally written for [redacted] franchisees and communications previously published. These demonstrate the intimidating and soul-destroying nature of my experiences whilst endeavouring to regularize injustices experienced as a [redacted] franchisee - when all else had let me down:-

"THE ART OF WAR was written over 2000 years ago by Sun Tzu, a Chinese military strategist. It is used today, not only as a battlefield treatise, but also by some businesses as a manual, providing techniques on annihilating their (competitors) enemies.

Senior [redacted] corporate officers are declared aficionados of these techniques, as many of you know - and as referenced in the copy e-mail below. Those of you who read the book, will note many parallels in the corporation's treatment of its franchisees - and observe that this is hardly the way the dominant player within a franchise system should behave towards its very own franchisee "partners".

The following communications with [redacted] (Chairman and CEO of the [redacted] Corporation in the USA) are self-explanatory. The various letters have been assembled in chronological order, and form the main body of the message, e-mailed to concerned people.

The Lack of Ethics
Subject: [redacted] Corporate Governance ~ and the lack of ethics #3
To: All [redacted] Licensees
From: Rod Hackett
Date: 10 September 2001

Hi,
During my recent meeting with a senior federal parliamentarian, it became apparent that franchisees have a major task ahead, if we are to convince the powers-that-be, that we need our small businesses protected from the worst excesses of franchisors. More than anything else we need more relevant and supportive law and codes of practice.

Lobbying the political parties will advance this issue.
As you might be aware, this is one reason why I have also taken my cause right to the doorstep of [redacted]. I wanted to advance the cause of franchisees and ensure, that in the future, no one will receive the kind of treatment that I have experienced over the past few years at the hands of the Corporation.

What of course happened when I tried to engage [redacted] in a calm and reasoned dialogue was a complete refusal to accept that there is any issue to be addressed and a complete denial of the need for the Corporation to be transparent in its dealings with local franchisees.

So much for the widely vaunted "open-door" policy.

To understand how I have come to this conclusion I will very briefly summarize the communication exchanges between [redacted] and me. I have attached the relevant correspondence, which you may read if the current corporate behaviour of our business partner is of interest to you.

15 May 2001:
Followed up an email with a letter to [redacted] attaching a number of documents including [redacted] report to the Corporation, my submission to the Australian Government and an excerpt from the Law Institute Journal outlining the reasons why my action in the Supreme Court was a major win for franchisees.

1 June 2001:
Wrote to [redacted] updating him on the letter that [redacted] sent to all franchisees (except me) and attaching my response.

6 June 2001:
Received a note from [redacted] Vice-President, General Counsel - International, informing me that if I had any concerns with my business arrangements with [redacted] Australia, I should direct them to (wait for it ....) [redacted]

26 June 2001:
Received a letter from [redacted] which slammed the open door in my face by insisting that he had no concerns with the corporate governance of [redacted] Australia and, further, that I should address any concerns to (you guessed it ....) [redacted]

27 June 2001:
Sent a letter expressing my deep concern regarding the Corporation's disavowal of the need for ethical behaviour, to which, as yet, there has been no reply!

And that's where the situation now stands. A slammed door, and many corporate heads in the sand.

All the issues canvassed by me, from Corporation-instituted devastation of individual franchisee's businesses, to the Corporation wielding its massive resources in unethical ways to advance its own interests, affect us all on a worldwide basis.

These issues must be redressed.

As with government, we get the Corporation we "deserve". We small business people deserve a lot better. If enough franchisees act, the right changes for the better will be achieved.

A few hundred years ago, it was Edmund Burke who made the pertinent observation: "The only thing necessary for evil to triumph is for good men to do nothing."

Let [redacted] the politicians, and any other influential people you know, understand your views on the need for expeditious change in respect of these matters.

Without change, the Corporation will only become richer: and always at the expense of the financial and emotional investment made by each of us.

Best regards,
Rod Hackett.
[redacted] Licensee.

Attachments:
15th. May, 2001.

Mr. [redacted]
Chief Executive Officer
[redacted] Corporation
1 [redacted] Plaza
Oak Brook
Illinois 60523
USA

ATTENTION: [redacted]

Dear [redacted],

Re: [redacted] Corporate Governance
Re: Hackett & Far Horizons Pty Ltd v. [redacted] Australia Ltd

In the event that you have not received my recent email, I am forwarding you the enclosed information. I believe it is vitally important that communication is at all times frank and transparent.

The information comprises:

Text of my recent e-mail addressed to you.
Copies of the attachments referred to in the e-mail:
[redacted] report to the corporation.
My submission to the Australian Federal Government
Excerpt from the Law Institute Journal of March 2001.
I have also enclosed a copy of my letter to the corporation dated 24th April 2001. This letter is my considered response to the particularly unfair positioning statements made by the corporation in my 2000 Operator Review Recap.

It is clear to me that the Recap has been used as just one more means by which the corporation is attempting to make our relationship an unproductive one. Indeed, it was the Recap that made my recent email mandatory.

I would like to point out a number of totally unacceptable activities undertaken by the corporation since those complained about in my 1996 Supreme Court writ.

Some of these are:-
[redacted] (CFO) approach to my estranged wife.

I'm informed [redacted] (CEO) advised around 70 licensees at an assembly in Sydney, in February 2001, that
:
Hackett had harmed the system ~ please understand that I was not there to defend myself against this slanderous accusation.

The corporation had wanted to settle the matter but Hackett had not ~ this surely is a breach of confidentially designed to harm me. It is also untrue.

The solicitors for the corporation, at the taxation of its legal costs, read out file notes, noting the US corporation was very concerned about the international ramifications if the case was lost, whilst [redacted] insisted no settlement could be effected with Hackett, as he would then have shown the licensee community how it could be done.

The corporation had offered Hackett the equivalent of $8 million. This is a lie.

The corporation has recently opened a food court store at the remodelled Fountain Gate Shopping Centre and, needless to say, refused to consider me for the relevant licence. (This store is in a different situation to the one the corporation intended to open in 1996.) The store was opened despite all corporation assessments done, that it would cause (and has caused) substantial damage to my small business.

[redacted] (in-house senior corporate counsel) recently made an approach to my bankers in an effort to obtain details of my private financial arrangements with the bank.

After the issue of my writ in 1996 a number of events in the [redacted] community took place: Shortly afterwards, [redacted] was formed. [redacted] has no constitution, and is essentially a group of licensees, obliged to sign a confidentiality agreement with the corporation, who are ostensibly used by the corporation as a sounding board.

Around the same time, at a licensee only meeting at Collingwood, [redacted] (a licensee) led a round of applause for my actions.

In February 1997 at a Licensee Convention breakfast in Perth, [redacted] (a member of [redacted], and presumably now "advised" to treat me as an "undesirable") told me: how could you expect to have a sound relationship with the corporation when you can't even keep your marriage together (my wife, [redacted] had left me in December 1996).
[redacted] (a licensee and [redacted] member) has routinely stifled licensee efforts to have me present my side of the story to the licensee community.

[redacted] (a licensee, and member of the relatively new Leadership Council ~ seemingly a permutation of the still existing [redacted]) provided the corporation with the secret 1996 Notes from Dick Adams Visiting Melbourne, and the notorious [redacted] Charlesworth document. [redacted] was also present at the [redacted] presentation to licensees in Sydney in February 2001 (referred to above).

(vi) [redacted] has been telling licensees to ostracise me; and not speak with or have coffee with me during coffee breaks at meetings, as I was responsible for causing great damage to his business.

(vii) I informed the corporation about [redacted] behaviour. To my knowledge they have done nothing, other than to criticise me for attacking the integrity of their people.
Interestingly, all the above is redolent of the abusive protocols outlined in the [redacted] Charlesworth Meeting Minutes, for the removal of licensees.

It should be noted tha[redacted], and [redacted] have studied, and are acknowledged aficionados of, the (win-at-any-costs) principles in Sun Tzu's, "The Art of War". These principles encompass everything from the use of spies, through to tactics of divide-and-conquer. Pursuit of these principles within a business system against one's partners seems, at best, misplaced, and at worst, dangerous in the extreme.

My lawyers in respect of this writ, took statements from around forty licensees supporting my allegations of poor corporate governance, and with their own stories of mal-treatment and unconscionable conduct occasioned by the corporation. Needless to say, none of these licensees wished to appear in court, and, as a matter of principle, I would not allow them to be subpoenaed.

[redacted], as a co-investor in the [redacted] System, I appeal to you to introduce some ethics into the alarming conduct of some of your senior executives.

These executives are making short term decisions of appalling consequences, which are bringing the System into disrepute, reducing the long term viability of the businesses of both the corporation and its licensees, and knocking out the motivation (of many in the licensee community) essential to the success of the System.

I ask you to fully investigate this conduct, which I am now bringing to your attention. I further ask you not merely to accept the "sanitized" version of events concerning me, which you are undoubtedly being provided.

If you are able to sensibly intervene in this matter, I would be most grateful if you could advise me of your intentions, at your earliest possible convenience.

Yours sincerely,
Rod Hackett.
[redacted] Licensee.

1st. June, 2001.

Mr. [redacted]
Chief Executive Officer
[redacted] Corporation
1 [redacted] Plaza
Oak Brook
Illinois 60523
USA
ATTENTION: [redacted]

Dear [redacted],

Re: [redacted] Corporate Governance: Ethics & Transparency

I refer to my email and separate letter addressed to you, both dated 15 May 2001.

It is important for me to update you on the events that have followed my limited distribution of the email.

Since then, [redacted] (CFO of [redacted] Australia) has seen fit to distribute to all licensees, a disingenuous response to my email. While I preferred not to undertake a public email exchange with him, I was obliged to counter this disinformation campaign by the corporation, with a further memo of explanation, forwarded to all licensees.

In the belief you may not know of the tactics being employed by the Australian arm of the corporation, I have attached copies of:

[redacted] memo to all licensees dated 8th May 2001.
My further memo of explanation to the licensees dated 25th May 2001.
The tactics employed by some of the corporation's officers do not appear, unfortunately, to be isolated aberrations.

They appear to be part of a concerted effort to spread disinformation to tarnish the reputation of targeted licensees with the aim of driving them out of their businesses.

Even [redacted], former CEO of [redacted] Australia, and currently your new head of [redacted] in Europe, a few years ago told a group of licensees, of which I was part, how he helped a senior officer in [redacted] France to surreptitiously litter the "targeted" Parisian licensee's store in the middle of the night ~ from litter they had emptied into their car boot from a rubbish bin ~ and then to have him adversely graded in the morning, for having a dirty lot.

[redacted], I know that many of the licensees had hoped, and continue to hope, that following your appointment as CEO, proper ethical conduct by the corporation's officer corps, would become the new way of doing things.

For this reason, I respectfully request you to intercede.
I ask you to use your authority to properly investigate the unethical and unconscionable conduct of some officers of the [redacted] corporation.

In the interests of protecting and, perhaps enhancing, the local image of the corporation, I would also appreciate receiving your urgent reply to this and my earlier correspondence.

Thank you in anticipation of your earnest assistance.

Yours sincerely,
Rod Hackett.
[redacted] Licensee.

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6 June 2001.

From: [redacted]
To: [redacted]
Subject: Your Correspondence to [redacted]
Date: Wednesday, 6 June 2001 6:18

Dear Mr. Hackett,

Thank you for your e-mails and attached materials dated May 15 and June 4 to [redacted]

[redacted] has asked me to respond to you.

It would not be right or appropriate to comment on the matters raised in your correspondence, other than to confirm to you the utmost confidence and trust in which the management of [redacted] Australia Limited, both past and present, is held by [redacted] and the senior management of [redacted] Corporation.

If you have any other concerns about any matter relating to your business arrangements with [redacted] Australia Limited, could you please direct them to [redacted] at that company's offices in Sydney.

Regards,
[redacted]
Vice President,
General Counsel - International

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26 June 2001.

From: [redacted]
To: [redacted]
Subject: Your Letters
Date: Tuesday, 26 June 2001 10:49

Dear Mr. Hackett,

I have received your letter of June 1, 2001 with its attached materials. I understand that [redacted] responded on June 5 to your e-mails to me of May 15 and June 4, the latter being a copy of your June 1 letter.

I have always believed in doing everything possible to try to resolve any disagreement between [redacted] and its franchisees in good faith and in the spirit of collaboration and partnership. That process needs good will and for each side to have a realistic sense of the expectations of the other side. Equally, I have always believed that once a franchisee has decided to have a disagreement with [redacted] resolved by a court or other third party, there is no more room for

dialogue. When a franchisee seeks a judicial remedy for a matter in dispute, as he or she is entitled to do, the matter must, for better or worse, be resolved by the court.

You have requested that I investigate what you feel to be unethical and unconscionable conduct on the part of some officers of [redacted] Australia Limited. As you know, your matter has been thoroughly reviewed by the Australian court. I can add nothing to the good sense expressed by the judge in the lawsuit that you initiated.

I would confirm to you, Mr. Hackett, that I have no concerns with corporate governance in [redacted] Australia Limited. I have complete confidence and trust in both the sense of fairness and the ethical standards with which the management of [redacted] Australia Limited, both past and present, has conducted and continues to conduct its business.

Finally, I would ask you to address any other concerns about any matter relating to your business arrangements with [redacted] Australia Limited to [redacted] at that company's offices in Sydney.

Regards,
[redacted]
[original to follow by mail]

27th. June, 2001

Mr. [redacted]
Chief Executive Officer
[redacted] Corporation
[redacted] Plaza
Oak Brook
Illinois 60523
USA

Dear [redacted],

Thank you for your response of 26th June 2001. I appreciate how in ordinary circumstances, you would prefer me to deal with your local corporation officers. Unfortunately, you are requiring me to deal with the very person who has made the issues quite personal ~ and as otherwise noted, has stated he does not believe a settlement (read: a proper resolution) should be reached with me. You, no doubt, are quite aware of the recent, post-trial efforts of your Australian corporation (see my earlier communications,) to fallaciously attempt to persuade the licensee community to "caste me into the wilderness". The e-mails from both yourself and your legal counsel, appear to be condoning conduct that ordinarily should merit severe censure. I can only hope this is not really the case.

As Chief Financial Officer, [redacted] has proclaimed to the licensees generally; " judges can be very unpredictable". My lawyers have statements from around forty licensees, all with their own stories of intimidation and bad faith by the corporation. This information was available, if you were not otherwise aware, prior to the trial of my case. However, I refused to allow any of these

potential witnesses to be subpoenaed in support of my case, to protect them from corporation recriminations.

It is not really good enough for the parent corporation to effectively disavow the matters I am bringing to its attention. The full story has not yet been heard.

Many licensees around the world are still hoping you may be able to rejuvenate a moribund system, and to re-establish the faded esprit de corps of the licensees ~ so essential to the success of the system. This will mean ensuring licensees henceforth receive an experience of fairplay from the corporation. This would ensure the long-term viability of the system, but perhaps at some diminution to the massive short-term profits, taken by the "stakeholders" in the real estate held by the corporation.

[redacted] I have attached my response to [redacted] letter allegedly forwarded to me on the 29th May 2001, which in itself, is largely self-explanatory. Please do not wash your hands of this matter, especially if you believe in fairplay.

Yours sincerely,
Rod Hackett.
[redacted] Licensee.

ATTACHMENT: E-mail to licensees of 24th June 2001

FOLLOWING is the: E-MAIL to (Australian) licensees of 24th June 2001

Hi,

Following is a self-explanatory letter pertaining to [redacted] letter to me dated 29th May 2001.

I'm copying this to you, to ensure the issues being debated by [redacted] are kept in perspective.

A scanned copy of the original Charlesworth minutes containing the abusive protocols for the removal of licensees, is available if requested. The file is about 1MB in size. Dick Adams of the Franchise Equity Group also can supply copies.

I have also attached a copy of an interesting article from the Herald Sun of the 21st June 2001, detailing the "biggest winners" from the corporation's recent share buy-back.
Best regards,
Rod.

22nd. June 2001

[redacted]
Chief Financial Officer
[redacted] Australia Limited
21-29 Central Avenue
Thornleigh
NSW 2120

Dear [redacted],

I refer to your letter of 29th May 2001 addressed to me. For some reason, I have not yet received this from you; other than for copies passed on to me, by other licensees to whom it was distributed.

As you know, I have been communicating all my concerns to the highest levels of the corporation, on an on-going basis. Regrettably, I have found our much-vaunted open-door policy, decidedly shut.

Let me remind you about the abusive protocols for removing Owner/Operators (O/Os) from their businesses, as set out in the [redacted] corporation's U.S. (Charlesworth Region) "Wrap Up Session" minutes.

In summary, these protocols, which address the question "How will we remove O/Os who wont sell after they fail LOI?" [Last Opportunity for Improvement] are:

'In your face' management; 'We don't want you; you are hurting the system', share information with fellow O/Os, don't provide assistance normally available to O/Os.

People don't want to work with people that don't want them; they will leave.
Greed: 'When we grow around you, your asset value will diminish over time', due to the impact on an O/Os restaurants. "

Like many other licensees, I have experienced the corporations attempts to implement these protocols against me. You presumably are aware of such similar problems experienced by other licensees.

My hope is that no more licensees will have the experience, first hand, as I have. These experiences suggest the corporation was implementing 'in your face' management, casting me into the wilderness, and diminishing my asset value.

Your letter of the 29th May 2001, references just a few examples:

There was not merely one of your lawyers "observing", during the trial of my matrimonial proceedings, but two ~ and for four days.
My lawyers noted a private investigator spying on our settlement discussions, at these same proceedings.

An excerpt from my estranged wife's statement (provided to my lawyers), refers to you contacting her, prior to the commencement of the trial of my proceedings against the corporation, and says (inter alia): "[redacted] later stated: 'You do know [redacted] we cannot afford to let Rod win.' It sounded like a warning, and it felt chilling."

[redacted], I am committed to achieving a win/win situation for the partners in the system: the licensees and the corporation. The way this can be achieved I believe, is by creating a genuine experience of fair-play for the licensees, especially in respect of our financial and emotional investment in our businesses.

In the court case, the judge determined the corporation is obliged to act in good faith and fairly in its dealings with its franchisees. Whilst he found I had not proved my case, I trust the judge's determination will assist the corporation in setting parameters for its future dealings with its licensees.

I am sure that as the corporation's Chief Financial Officer, you will now be prepared to listen more carefully to the expressed concerns of the licensees, who after all, make the system work.

Yours sincerely,
Rod Hackett.
[redacted] Licensee"

4.5.5 Epilogue

It is worth noting the following, in the instance of my tribulations with [redacted]:-

Nearly four years after my Supreme Court writ, complaining of damaging conduct by [redacted] towards my business at Fountain Gate and I was issued, the matter finally came to trial - and judgment was delivered in ***Far Horizons Pty Ltd and Rodney Hackett v [redacted] Australia Ltd.*** I had lost my action against [redacted] and incurred millions of dollars debt in related expenses, including paying [redacted] around $1.1m in legal costs awarded in its favour. The extensive time delay had enabled [redacted] to pour plenty of oil on troubled water with its other franchisees, but I was left out on the end of the proverbial limb. It had also learned from some of its past mistakes, although, regrettably, at my expense.

Shortly after delivery of the judgment, and [redacted] failure to bankrupt me, it proceeded to construct and open a Food Court Store in the new and now extensively expanded [redacted] Shopping Centre at Fountain Gate. And, then, as some mitigation for the damage that would be incurred by my store at Fountain Gate, I was, unusually, provided with a $250,000 re-investment allowance quite shortly after the opening of the nearby store.

[redacted] also made it relatively straight-forward for me to sell my stores on my exit from the System in 2007. One of the many otherwise excellent features about the System itself (which enables it to carry on despite the sometimes poor judgment calls of some of its officers,) is the well established protocol whereby franchisees are able to realise the equity in their small business by selling it to an approved purchaser - largely irrespective of the remaining term of their franchise at the time of sale.

It might also be noted [redacted] endeavoured to gag me as a pre-condition to approving the sale of my stores. This I refused to do. [redacted] relented, and the sale proceeded.

5. REFORM OF THE CODE OF CONDUCT AND FRANCHISING LAW

To better achieve a dynamic and trouble-free relationship between the parties to a franchise, this submission contends there is a pressing need, for parliament to now expedite the reform of the currently inadequate law relating to franchising, and to properly consider the following as part of such reform:-

5.1 Good Faith

The duty of good faith needs to be acknowledged as central to the conduct of the parties to a franchise arrangement, and be specifically introduced as an express part of franchising law. This, at the very least, would require franchisors to be more reasonable, factual, and fair in the exercise of discretionary authority authorised in the franchise contract.

5.2 Fiduciary Duty

The special and high level of fiduciary duty between the parties to a franchise agreement should be recognised, and specifically introduced as an express part of franchising law.

5.3 Fair Franchising Standards

A full set of Fair Franchising Standards needs to be introduced to better guide judges and arbiters of disputes, let alone the franchising industry itself, to provide a guide to better determining what is fair and reasonable conduct for the parties to a franchising arrangement. A draft set of points for development into suitable Standards are included in the Appendix[1] for consideration by the Inquiry.

5.4 Franchising Act and Statutory Regulations

Given the imbalance of power, finances, and resources between the parties, it is inappropriate for the market itself to be largely responsible for regulation of the franchising industry. The TPA is really an inappropriate Act for dealing with the problem issues raised in this submission.

Ideally, the laws relating to the industry should be provided with a dedicated Act and appropriate Regulations, with properly enforceable sanctions and penalties for non-compliance; but, at the very least, they should be brought under the auspices of an existing Act which is more closely aligned to the fundamentals of franchising, such as the Independent Contractors Act.

Footnote[1]: see Appendix at page 52

5.5 Individual Accountability

Franchisees, by their very nature, are for all practical purposes, personally liable for the actions of their small-businesses, and usually are vulnerable to losing their emotional health, and all their wealth, down to the metaphorical shirt on their back, if it all goes wrong.

On the other hand, the officers of a franchisor company (usually being a bigger business or even a publicly listed corporation) by comparison, are largely immune from such risk. As it is, a franchisor officer intent on advancing their career prospects, can too easily carry out unethical or nefarious orders (or expectations) of their franchisor employer - as currently it is the franchisor company which is vicariously liable for the individual actions of its officer, and not, in fact, that officer.

There would be significant reduction in such inappropriate behaviour by franchisor companies, if franchising law imposed sanctions, including criminal sanctions for breach of the Code of Conduct, or relevant Statutory Regulations. These sanctions should apply personally to the individual offending franchisor officer or officers, if parliament is serious about obtaining compliance with the Code and pertinent Regulations.

5.6 Franchising Tribunal

A franchisor must not be immune against the consequences of its own bad faith just because the franchisee may not have the financial capability of issuing or defending against a Supreme Court writ. Procedural protocols for enforceable dispute resolution must be made straight-forward and accessible.

The Government should establish a Franchising Industry Tribunal which would have the power to resolve disputes between franchisees and franchisors, and the Tribunal should be able to amend unfair contracts, pass legally enforceable orders, and impose pertinent sanctions for non-compliance. Failing the establishment of a suitable Tribunal, then, it is submitted, the Federal Magistracy should be so empowered.

5.7 The Commonwealth Financial Services Reform Act 2001

It is submitted the Commonwealth Financial Services Reform Act 2001 (and Regulations) provides useful governmental insights into how it has dealt with an industry which has some striking financial parallels.

Rodney Hackett
27 August 2008

6. APPENDIX

6.1 Examples of [redacted] Australia's contradictory representations to prospective franchisees

i.e. contradictory to the reality of the issues raised in this submission.

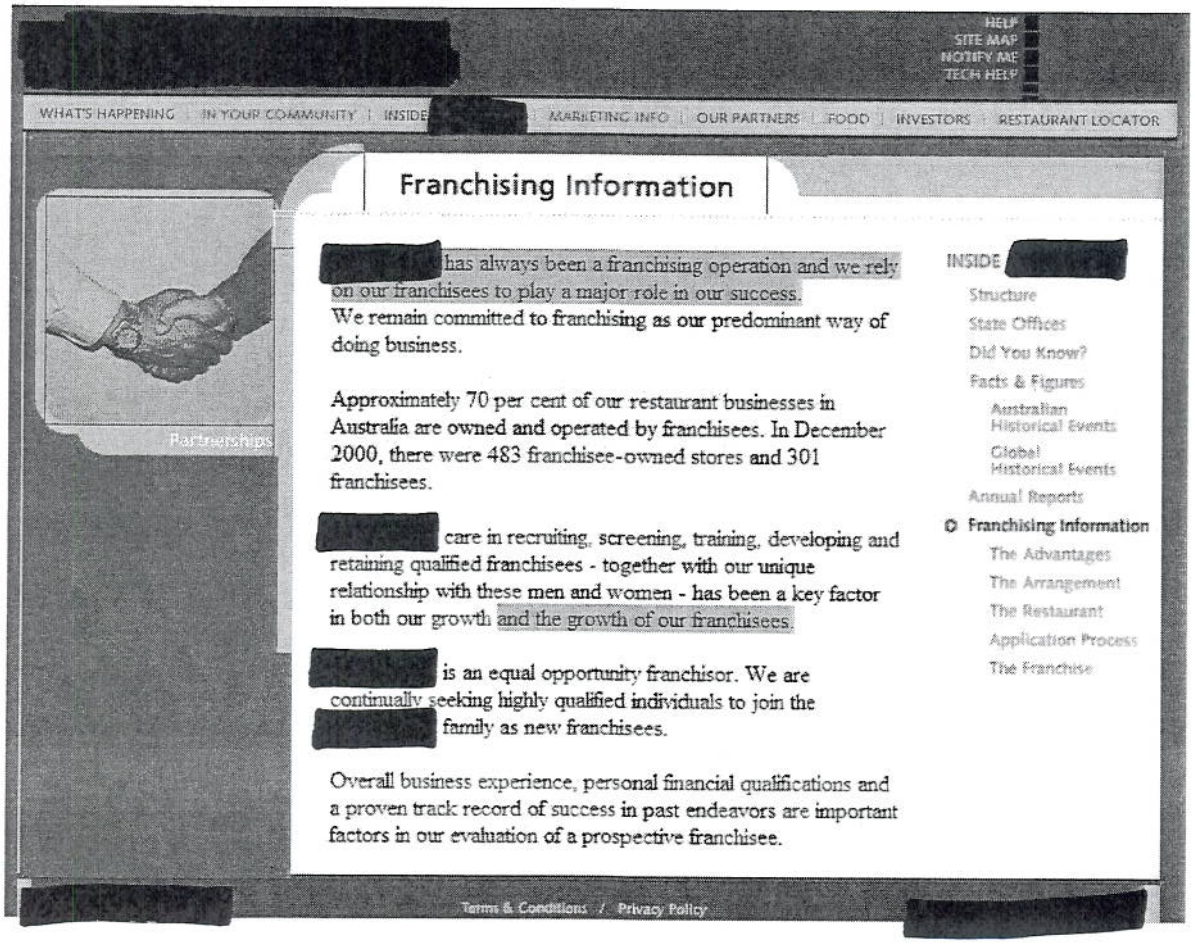
- Images obtained from [redacted] Australia's website.
- The grey highlighting is mine - **R.H.**

[redacted] Australia - Franchising Information:

[redacted] has always been a franchising operation and we rely on our franchisees to play a major role in our success.
We remain committed to franchising as our predominant way of doing business.

Approximately 70 per cent of our restaurant businesses in Australia are owned and operated by franchisees. In December 2000, there were 483 franchisee-owned stores and 301 franchisees.

[redacted] care in recruiting, screening, training, developing and retaining qualified franchisees - together with our unique relationship with these men and women - has been a key factor in both our growth and the growth of our franchisees....."

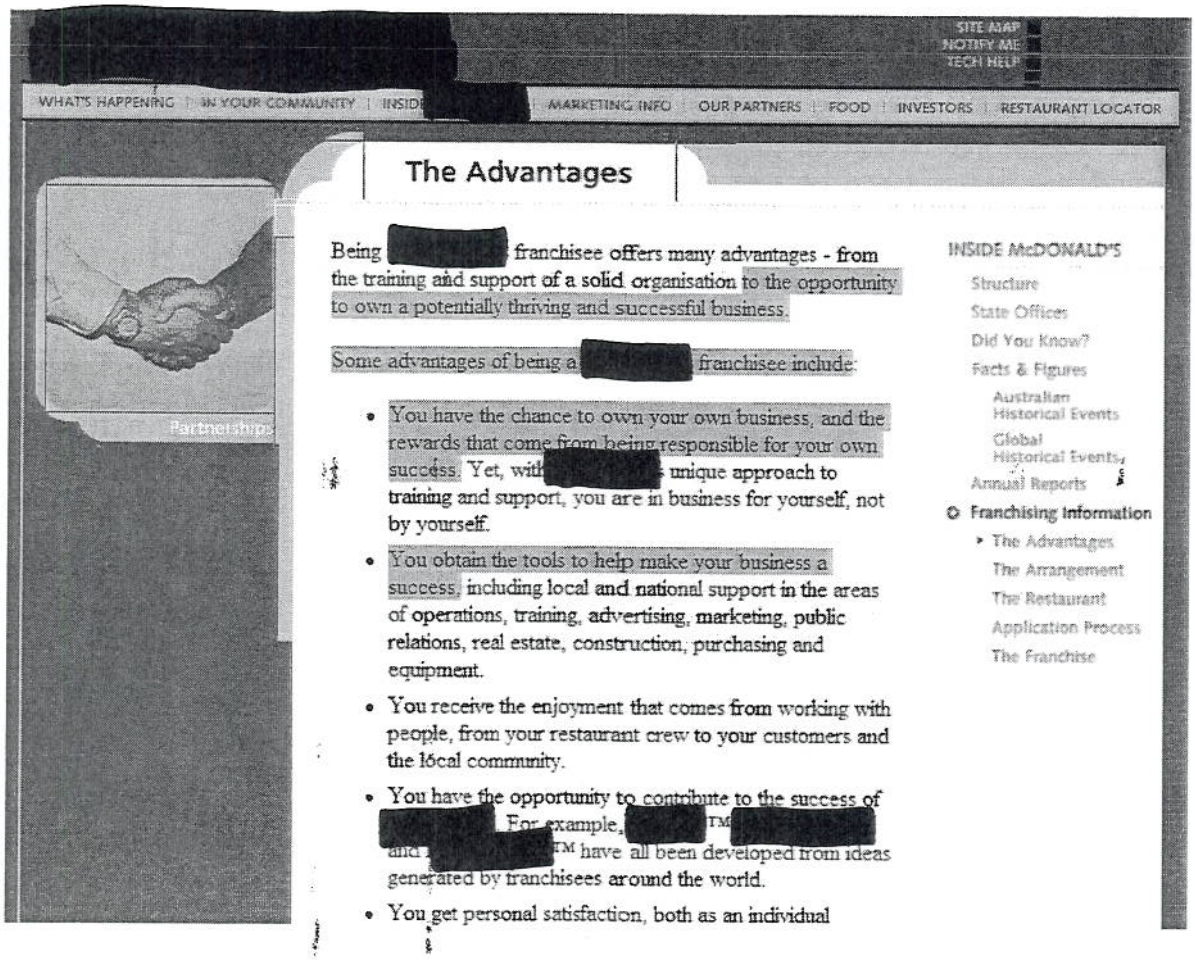


[redacted] Australia Franchising – The Advantages:

Being a [redacted] franchisee offers many advantages - from the training and support of a solid organisation to the opportunity to own a potentially thriving and successful business.

Some advantages of being a [redacted] franchisee include:

- You have the chance to own your own business, and the rewards that come from being responsible for your own success. Yet, with [redacted] unique approach to training and support, you are in business for yourself, not by yourself.
- You obtain the tools to help make your business a success, including local and national support in the areas of operations, training, advertising, marketing, public relations, real estate, construction, purchasing and equipment....."



6.2 Suggested points for development into Fair Franchising Standards

To better achieve a dynamic and trouble-free relationship between the parties to a franchise, a proper set of Fair Franchising Standards (FFS) should be developed - as a guide for determining what is fair and reasonable conduct for the parties.

The following points are suggested for consideration by the Inquiry for appropriate development into such a set of FFS. The points should also be developed with appropriate detail on what is *reasonable,* wherever that term is used - to reduce the need for interpretative "assistance" by a slow, expensive, and unreliable litigation system:-

A. Before entering into a binding franchise agreement, the franchisor:-

1. Must clearly explain and demonstrate its business model to a prospective franchisee.

2. Must provide reasonable and satisfactory evidence of its solvency to a prospective franchisee.

3. Must describe and detail the business structure of which it is part, and where the franchisee business units fits.

4. Must effectively own and operate a reasonable number of comparable business units to that which it has on offer (or will offer) to its prospective franchisee, and the franchisor must provide a reasonable opportunity to its prospective franchisee to assess the pros and cons of (a typical) such unit.

5. Must provide a reasonable opportunity for its prospective franchisee to privately discuss the pros and cons of the business model, in practise, with several existing franchisees.

6. Must disclose the existing number of business units it effectively owns and operates itself, and those it has franchised.

7. Must disclose the projected number of new business units it plans to open over the next three years within Australia.

8. Must produce a reasonable feasibility study for any newly founded franchisee business unit under offer.

9. Must produce an adequate financial history for any pre-existing business unit under offer.

10. Must produce a reasonable three year projection of the realistically anticipated Profit & Loss for the business unit under offer.

11. Must produce a reasonable ten year projection of the future capital costs and future reinvestment requirements for the business unit.

12. Must provide proper information before and during the currency of the franchise, on what an effective franchisee can genuinely expect to obtain by way of Return on Investment and Return on Equity from the business.

13. Must produce details of any relevant Lease and/or Sub-lease for the premises for the business unit.

14. Must provide reasonable preparatory training for the prospective franchisee.

15. Must produce a complete list of all charges to be imposed by the franchisor upon the franchisee - including for: royalties, rent, advertising & marketing levies, training, site inspections, conferences, computer support/installation, etc.

B. Upon entering into and during the franchise, the franchisor:-

16. Must provide reasonable ongoing training and support.

17. May not unilaterally make fundamental changes to the nature of its declared business model by merely effecting a change to its Operations Manual, or equivalent.

18. Must disclose all rebates and other benefits receivable by the franchisor or its officers during its conduct of the franchise business.

19. Must hold all Advertising & Marketing Funds in trust on behalf of the franchisees who have contributed to the fund.

20. Must provide a reasonable say for its franchisees in the spending of Advertising and Marketing Funds.

21. Must provide a minimum reasonable ongoing Advertising and Marketing support for the business.

22. May not impose an unreasonable ceiling selling price for any of the goods and/or services to be sold from time to time by the franchise business.

23. May not make any changes to its distribution methods without adequately taking into account the interests of its franchisees.

24. Must not engage in Third Line Forcing.

25. May not unreasonably prohibit its franchisees from sourcing equipment, goods or services from sources other than "Recommended or Preferred Suppliers".

26. Must not require any unreasonable non-compete clauses in the Franchise Agreement; and any such non-compete clauses must be commensurately reciprocal.

27. Must not require any unreasonable "cure periods" for actual or perceived breaches in the Franchise Agreement; and any such clauses must be reciprocal.

28. Shall provide for reasonable dispute resolution procedures and litigation venues, in the Franchise Agreement.

29. May not prohibit or restrict group mediation of disputes effecting more than one of its franchisees.

30. May not prohibit or restrict its franchisees from having reasonable representation at mediation or arbitration, such as from a representative association.

31. Must ensure all its franchisee gradings and assessments are demonstrably transparent and consistent across the franchise system.

32. Must provide comparatively equal treatment for each of its franchisees.

33. Must provide its franchisees with adequate and reasonable accounting support.

34. Must provide a reasonable franchise term, having regard to the need of the franchisee to recover their investment in the business unit during such term and/or upon sale of their business unit.

35. Must not unreasonably impede or restrict a franchisee's growth of their equity/capital and/or profit/income, and is obligated to support its franchisees in attaining reasonable growth in their business unit, having regard to the growth in the business of the franchisor itself.

36. Must provide each of its franchisees with a reasonable history and a monthly update of such part of the Profit & Loss statements of each of the individual franchisee and franchisor business units across the franchise system, at least sufficient to adequately enable each franchisee to adequately assess their own business unit's financial performance against comparable or similar such units.

37. Must provide each of its franchisees with a reasonable history and an annual update, of comparable franchisee business unit capital growth across the franchise system.

38. Must provide reasonable territorial rights to each of its franchisees, or otherwise provide proper protocols to ensure any franchisee's sales are not unreasonably cannibalised by franchisor initiatives or actions.

39. Must provide existing franchisees a reasonable first-right-of-refusal on any new outlet which the franchisor intends opening which is located within the trading area of an existing outlet, or otherwise provide proper protocols to ensure its franchisee's sales are not unreasonably cannibalised.

C. Approaching, and upon termination of the franchise, the franchisor:-

40. May not gag a franchisee on matters which are not proprietary, particularly upon termination of a franchise.

41. May not unreasonably require a franchisee to enter into a legal Release as a condition of the franchisee selling their business unit.

42. Shall allow and facilitate the franchisee's sale of (or assignment of interest in) their business, for fair value; and provide (or otherwise) a new franchise on reasonable terms for any approved purchaser, as part of the sale arrangement. The franchisor shall not unreasonably refuse approval of a prospective purchaser.

43. Shall have a "buy-back" scheme in place to reacquire the franchise business upon reasonable terms and conditions from the franchisee at the conclusion of the franchise arrangement.

44. Will not fundamentally change the terms or nature of the franchise upon any renewal of the franchisee's franchise.