PARLIAMENTARY JOINT COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

INQUIRY INTO

FRANCHISING CODE OF CONDUCT

& OTHER RELATED MATTERS

SUBMISSION

By:

SUZANNE BROWN

(Franchisee : July 2002 – September 2005)

TABLE OF CONTENTS

PART II

PART I

1. OPENING STATEMENT

I welcome the opportunity of presenting my opinions and thoughts to the Committee regarding the operation of the Franchising Code of Conduct and other related matters.

I will attempt to cover the Terms of Reference and where possible provide examples to substantiate the rationale behind my suggestions.

I am one of those unfortunate Australians who bought into a so-called 'reputable' and 'proven' franchise system. I never expected to make millions but did have the modest dream of paying off my small mortgage over the 5 years I had planned to stay in my store. Nor did I expect a 100% guarantee of success. I was aware there were risks involved in the operation of a small business, that's why I chose franchising. I, like so many others, believed franchising offered an element of protection against the usual pitfalls. I do not believe this to be an unrealistic assumption, based on the marketing of franchising through the media and internet, various business consultants' comments and the *'peak body'*, the Franchise Council of Australia, in addition to the franchisors' own advertising and marketing of their systems.

What I did expect though was that my franchisor and master franchisee honour their obligations under the Code and the Agreement and provide that which was asserted in the promotion of their 'proven' system.

One has to remember that franchising is marketed to the 'mums and dads' of Australia, who generally, would not have had exposure to running a business themselves and therefore have little business acumen to rely upon. The following marketing propaganda is an example of what was used by my former franchisor to entice those looking to enter into this small business sector:

> *"Our Franchisees come from all walks of life and to provide every opportunity for them to succeed, we offer comprehensive training, a full calendar of promotional activities and on going field support from a team of experts."*

Sadly, all I got was an over abundance of promotional activities forcing me to sell products at ridiculously low prices.

In September 2005 I ultimately decided not to renew my agreement due mainly to the fact I could no longer endure the WA Master Franchisee's (*mis*)conduct and the Board's apparent unwillingness or inability to resolve the issues in WA. I was emotionally, physically and mentally drained and heading for a breakdown.

Had I decided to renew my Agreement, I believe they would have continued to put up obstacles of this eventuating and if by some miracle had they allowed me to renew, my life would not have been worth living with the grief the master franchisee would have continued to inflict upon me.

I was a Franchisee for just over 3 years. I consider those years as a nightmare from which I will never recover financially or emotionally.

Simply put, this franchisor together with their WA master franchisee wanted me 'out' of the System and in particular, the master franchisee made every endeavour to discredit me and applied undue pressure, intimidation and 'bully boy' tactics, the likes of which I have never witnessed in my 30 odd years of working.

I strongly believe my involvement with the then Australian Franchisees Association played a major role in the treatment meted out to me by the master franchisee with the knowledge of the Board, as I had communicated with them regarding the issues I was encountering on numerous occasions. In fact, the master franchisee confirmed, during a telephone conversation just days before I left my store, that the situation I was in was in fact due to my association with the AFA.

Had I known what my foray into the franchising world would realise, I certainly would not have ventured into this so-called 'reputable and proven' franchise system. In this day and age I cannot believe such draconian tactics are employed with such unabashed arrogance whilst seemingly allowed to continue unabated. All the due diligence in the world does little in reality to prepare you for what you will be forced to endure once you are in the System.

I have not been alone in taking the desperate measure of walking away from the business. The first five months of 2007 proved to be quite dramatic for this franchisor with 3 walk-outs, a possible bankruptcy and a question mark over another store which equates to 28% of stores in WA. I have been told by a then current franchisee that when querying the master franchisee about the walk-outs in 2007, they were told – they didn't walk out, I closed them down for operational reasons.

I trust this current Inquiry will, in their final report, make further recommendations for enhancement to the regulation and legislation of the Franchising Sector which will afford improved protection and security for current and future franchisees.

Further, I hope the Committee will not only address the further improvement of the Disclosure Provisions of the Code but also seek improvements and upgrades to strengthen franchisees rights against the despicable unconscionable conduct that some franchisors and their master franchisees regularly and consistently inflict on their franchisees.

This will make certain, best practice policies are obligatory on Franchisors, particularly in their dealings with Franchisees to ensure sustained financial viability in an environment which is substantially more conducive of a mature and respectful relationship without the threats and intimidation currently being imposed on franchisees.

The reality is, that it is the hard working franchisees who are burdened with the majority of the risk, financially and emotionally, putting their health and family in jeopardy to provide the income stream for the franchisor. The franchisor and master franchisee reap the benefits whilst wielding their mighty sword of supreme control with little regard to who falls by the wayside. The divide and conquer mentality reigns supreme in this business sector.

There must be a system and regulatory framework in place that protects the franchisee and holds the franchisor and master franchisee accountable for their actions. The consequences will continue to be dire should this not occur.

Should the current climate prevail there will be an ever increasing number of names being added to the list of those who have lost something, if not everything. Mine was added to that list in 2005. Regrettably, and one could say naively, I initially had faith in and trusted the purported benefits and features illustrated in my former franchisor's propaganda. I, like so many others, honestly believed their management personnel would have my interests at the forefront (or at the least parallel to theirs) and offer the support, training and encouragement to give me every opportunity to succeed - after all they are the 'experts'. It looked so professional and rosy from the outside – in reality a nightmarish black hole from within.

I am not aware of anyone who has left this particular franchise system happy. What a sad state of affairs that is. One would think the franchisor would strive to ensure the opposite was the case. Fostering a harmonious and balanced business relationship with their franchisees would only make their System stronger and more attractive, with current and former franchisees espousing the virtues of their "brand". Sadly though, this is not the case.

I believe there are a number of franchisors who are oblivious to the meaning of phrases such as 'duty of care', 'fair and reasonable' or 'in good faith' which has led to increasing numbers of franchisees willing to tell their stories in the hope that what has happened to them can be prevented from happening to others in the future.

It is reported that Franchising is a $130+ billion industry sector that employs more than 600,000 Australians. The industry has grown substantially over recent years and is a significant part of small business in Australia.

Unfortunately the security and plight of franchisees has been largely ignored with the interests and reputations of the franchisor appearing to have been of paramount importance.

To stabilise the Franchising Sector in Australia and to ensure the protection for all parties, particularly the franchisee, I believe it is time the Australian Federal Government seriously considered regulating the Sector, for example, by either:

1. Drawing up an Australian Franchising Act;

2. Transferring the regulatory and enforcement responsibilities to ASIC;

3. The creation of an Ombudsman Department together with the implementation of an effective and efficient Franchising Tribunal with the powers to act swiftly to remedy the behaviour of unethical and immoral Franchisors by the imposition of appropriate penalties, be them pecuniary or custodial.

Only then can the Franchising Sector grow with security, strength and certainty.

2. DEFINITION

The ACCC offers the following in their "Franchising Code of Conduct Compliance Manual for Franchisors and Master Franchisees":

> *"What is a Franchise?*
> *A franchise is a specific type of business that is regulated by the code. In a general sense a franchise is a business arrangement in which knowledge, expertise and a trademark or trade name are licensed to a franchisee, for an initial fee under specific conditions. These arrangements are formalised in a franchise agreement between the franchisor and its franchisees. A franchise agreement has a specific meaning under the code."* (1)

> *"Do I Have a Franchise Agreement?*
> *A franchise agreement under the code is an agreement (either written, verbal or implied) between a franchisor and franchisee……."* (2)

Two additional examples gleaned from the internet are:

> *"Franchising refers to the method of practicing and using another person's philosophy of business. The "franchisors" authorize the proven methods and trademarks of their businesses to "franchisees" for a fee and a percentage of gross monthly sales. Various tangibles and intangibles such as national or international advertising, training, and other support services are commonly made available by the franchisor. Agreements typically last five to twenty years, with premature cancellations or terminations of most contracts bearing serious consequences for franchisees."* (3)

> *"Franchising is a method of growing a business whereby a franchise owner ("Franchisee") is granted for a fee, the right to offer sell or distribute goods or services under a business system determined by the business founder (Franchisor). Further, the Franchisor supports that franchised business group by providing leadership, guidance, training and assistance, for which they receive ongoing service fees. It is important to note that a broad definition of franchising has been applied to this sector and incorporates revenue derived from the production of goods and/or service under a franchise licence along with service fees (i.e. franchise fees) paid to the Franchisor."* (4)

The obvious consensus of the above definitions is that the franchisor, for a fee, will provide training, expertise and support to the franchisee.

Prior to buying into a franchise, franchisees would agree that this is what their perception of franchising was. They are prepared to pay a premium for this service in the belief that it will help limit the risks involved in being a small business owner.

From conversations with many franchisees the overwhelming opinion is that these services were not provided to a level that was expected and required, particularly the training. Additionally the purported support was neither supplied nor on-going; and the 'expertise' provided by some levels of management was vague and inept to say the least.

(1) ACCC publication "Franchising Code of Conduct Compliance Manual for Franchisors and Master Franchisees" 04.08.2008 - Page 9

(2) ACCC publication "Franchising Code of Conduct Compliance Manual for Franchisors and Master Franchisees" 04.08.2008 - Page 11

(3) Wikipedia : (en.wikipedia.org/wiki/Franchising)

(4) IBISworld : (ibisworld.com.au)

3. THE FRANCHISING CODE OF CONDUCT

3.1 2006 AUSTRALIAN GOVERNMENT REVIEW

In 2006 the Federal Government carried out a Review of the Disclosure Provisions of the Franchising Code of Conduct. The Matthews Report which outlined the findings and recommendations of the Review Committee and dated October 2006 contained some 34 recommendations of which the majority were agreed to by the Government.

Whilst the amendments resulting from the 2006 Review will afford prospective franchisees the ability to make a more informed decision, I feel greater disclosure requirements could be implemented. Following are comments and further suggestions:

3.1.1 Matthews' Committee Recommendations

(i) Recommendation 8

"More Information about past franchisees"

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the number but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document."

Government response: "agreed to in principle"

Currently the franchisor is required to list franchisees for the last 3 financial years only. I believe the average franchisee "ownership" to be between 2.5 – 5 years.

Therefore, I feel this 3 year period should be extended to include information for the last 10 years. This will allow a prospective franchisee to ascertain possible problem areas in regard to high turnover of franchisees in a particular locale or State which could indicate that further investigation may be required.

(ii) Recommendation 16 & 17

16 – "The right of unilateral termination to a franchise agreement"
17 – "The right of unilateral change to a franchise agreement"

Government response: "This will be addressed through reform to section 51AC of the Trade Practices Act 1974 in relation to unconscionable conduct where unilateral variation clauses will be a factor that may indicate a corporation has engaged in unconscionable conduct. The Government will ask the ACCC to consider including this issue in their educational material".

To-date I do not believe this reform has been undertaken. May I suggest the Committee members revisit the recommendations as outlined in the Matthews report.

(iii) Recommendation 23

"Registration and Review of Disclosure Document"

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the code. This process would be administered by the ACCC.

Government response: Not Agreed. Registration of the franchisors and their disclosure documents could be seen as providing credibility to their claims and ACCC endorsement. The ACCC would not be in a position to ensure the quality nor the substance of the documents. The cumulative paperwork and the compliance burden upon franchisors is likely to be significant and would be at odds with the government's policy of reducing the regulatory burden on business, where possible.

The Government notes that the Franchise Council of Australia has implemented a national franchise-accreditation scheme. The Government will request the FCA to publish a report regarding the details of the scheme, its implementation progress and take-up.

May I suggest the Committee revisit this recommendation.

I agree, in principle, with this recommendation, although I believe:

(a) the ACCC is incapable of regulating the Franchising Sector. I believe the regulatory power and the responsibilities of the franchising sector should be placed in the hands of an Ombudsman (or similar) with a well trained and experienced team where their sole responsibility is the control and regulation of franchising.

(b) prior to stamping, all signed franchise agreements to be registered with the Ombudsman (or similar) to ensure changes have not been made on an ad hoc basis by the franchisor.

(c) all amendments to the disclosure document, including the franchise agreement, made by the franchisor to be submitted for approval to the Ombudsman (or similar) as and when they occur, to ensure they comply with the provisions of the code.

(d) The franchisor's management team (the Board) including master franchisees, state and territory managers and any field/business consultants be required to be individually registered. Registration to be dependent upon the completion and passing of a relevant course(s) that covers for example: "Understanding the Trade Practices Act and Franchising Code of Conduct" / "Understanding the Compliance Requirements" / "Train the Trainer" etc.

Further, has the Government requested the report from the Franchise Council of Australia regarding their

national franchise-accreditation scheme? If so, has the Franchise Council of Australia acted on this request?

Additionally, would it not be so, that a national franchise-accreditation scheme administered by the FCA, also imply credibility to franchisor's claims and endorsement. If the current regulator of the Code is not in a position to ensure the quality or substance of the documents, why and how is the Franchise Council of Australia better placed?

I note with interest that recently some FCA franchisor members have included the FCA logo in their print media advertisements. To the 'lay' person, this may imply the franchisor is 'accredited' and may offer the illusion of 'safety'.

(iv) Recommendation 25

"Implementation of the principle of good faith and fair dealing"

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

Government Response: The Government agrees with the intention that franchisors franchisees and prospective franchisees act towards each other fairly and in good faith. Section 51AC of the Trade Practices Act 1974 includes 'good faith' as a factor that can be taken into account when determining unconscionable conduct.

May I suggest the Committee revisit this recommendation based on the comments of Attachment F of the Matthews Report. [5]

Additionally, Dr Craig Emerson issued a Franchising Policy Statement dated 24 October 2007 in his capacity as Shadow Minister for Service Economy, Small Business & Independent Contractors. In the opening paragraph of the Statement he states:

"Labor supports improved franchisor disclosure and Labor believes that the Franchise Code should include good faith obligations as long as the scope of this obligation is well defined. Labor will give real teeth to the ACCC under a strengthened Trade Practices Act."

Now as the Minister for Small Business, Independent Contractors and the Service Economy, what are his intentions?

[5] Appendix 1 – Attachment F – Good Faith and Fair Dealing – the Matthews Report on the Review of the Disclosure Provisions of the Franchising Code of Conduct – October 2006)

3.2 Suggested Additional Amendments

3.2.1 s16 Part 3 – Prohibition on general release from liability

(1) A franchise agreement entered into on or after 1 October 1998 must not contain, or require a franchisee to sign, a general release of the franchisor from liability towards the franchisee.

(2) However, subclause (1) does not prevent a franchisee from settling a claim against the franchisor after entering into a franchise agreement.

I would like to suggest:

(a) The Franchisor be required to disclose any documentation that will be required to be formalised prior to exiting the System eg Deed of Settlement; and

(b) The Franchisor, in addition to (1) above must not require the franchisee to sign, a document containing a release/waiver of the franchisor from liability towards the franchisee when exiting the System.

Undoubtedly there is a requirement to protect the 'System' regarding the product, intellectual property and manuals. Though the requirement to sign a release/waiver is in effect a 'gag' order being imposed on the outgoing franchisee.

There may possibly be instances where it could be said that an exiting franchisee has 'signed under duress' as they were told that if they did not, settlement would be delayed or refused.

Should a prohibition not be applied to the requirement for the signing a release/waiver by an exiting franchisee, in the least, the requirement should be disclosed prior to the signing of any agreement.

The question needs to be asked: Do franchisors requiring such a document be signed on exiting, have an inherent understanding of and lack of confidence in their System which could subsequently generate situations or outcomes that could result in litigation?

This tactic could also be said to be another way the franchisor controls and manipulates the outcomes to best suit their own agenda.

Further, it seems to me, that the requirement for signing such a waiver/release on exiting the franchise system flies in the face of the spirit of s16 Part 2 of the Franchising Code of Conduct.

3.2.2 s15 Annexure 1 - Franchisor's obligations

15.1 (a) An obligation to provide training

(i) before the franchised business starts; and

(ii) during operation of the franchised business; and

(b) Any obligation that continues after the franchised business ceases to operate.

In the three copies of the Disclosure Document (dated 22.04.02, 10.05.04, and 01.10.04 it states "None" to all the above.

My former franchisor's marketing consistently states:

"*we offer comprehensive training and on going field support from a team of experts*"; and

"*xx's 6 week intensive Franchise Owner Induction Program equips franchise owners with the necessary skills in management, product make-up, operations, marketing, merchandising and staff training. xx's REAL initiative has been developed to complement xx's existing training program offering courses to improve franchise owners business skills and practices, as well as increasing the skills of their staff.*"

I would like to add that the franchisor and master franchisee were parties to the franchise agreement.

May I suggest this Section be divided into:

(1) "Franchisor's Obligations and Responsibilities"; and
(2) "Master Franchisee's Obligations and Responsibilities"

In addition, each of the above should qualify and detail their joint and several obligations and responsibilities in regard to the training provided, including specific details of the training programs that will be undertaken including time frames.

Included in this Section, I believe there is also a requirement to specify each party's obligations and responsibilities in regard to the extent and nature of the on-going support.

I received comments from the master franchisee such as "I'm not a babysitter", "it's not my responsibility" and "it's Head Office's decision" only to be told by head office it was up to the master franchisee. Such situations often left me wondering who was responsible for what and who was actually going to resolve the problem or issue at hand. I liken it to bashing one's head against a brick wall.

3.3 Suggested Additional Sections

3.3.1 Franchisor to Disclose System Benchmarks

Franchisor to provide system benchmarks for sales and all operational costs (expressed as a % of sales) for the 'System' as a whole and for each State and Territory individually.

During discussions regarding my financial status, I was told that my expenses were within the States averages, with the exception possibly of my employees wages. When I asked for details of the States' averages, I was told that they could not provide them as they could not rely on the information provided by franchisees on the Weekly Management Reports.

It begs the question as to how they can offer 'expert' advice and support if they are unaware of this type of information. Stating that they could not rely on figures provided by franchisees also reflects their inadequate level of training. Do

they not have a responsibility to ensure they make themselves fully informed of the status of each of their sites/locations. Or, do they in reality, really not want to know.

The importance of system benchmarks not only assists a prospective purchaser and/or their financial advisor in identifying any anomalies for the site being investigated, but highlights State/Territory differences in relation to the whole system.

Additionally, the disclosure of system benchmarks would be of obvious benefit to current franchisees.

3.3.2 Disclosure of New Site Openings

Franchisor to disclose any new outlet that may open during the next 12 months within a [xx] km (*to be determined*) radius of the store being investigated.

The opening of a new site/location in close proximity may impact negatively on the existing site, be it in the short or long term and may have implications on the due diligence being undertaken.

3.3.3 Disclosure of Alterations to Agreement on Renewal

Franchisor to advise/disclose if the renewal agreement has altered in any way from the previous Agreement.

As an example: In 2004, I was informed in the covering letter attached to the disclosure document, that the franchise fee would be increasing and a 2% rental administration fee would apply (note: I had been paying the rental administration fee since 01.07.02.)

They omitted to advise other changes, in relation to the chargeback facility, being :

(i) The inclusion, under the heading of Advertising, of a clause stating that the franchisee, in addition to any contribution to the Marketing Fund, expend annually an amount equal to not less than 2% of the gross turnover to promote the franchised business.

(ii) Some 46 pages before (i) above and in the terms & conditions of this facility the inclusion of a clause stating that if the franchisee agreed to use the facility they would be complying with the (i) above.

This change would have a dramatic financial consequence on those considering withdrawing from this facility, in that the franchisee would now be required to expend 5% of gross sales on marketing (3% to the marketing fund and 2% on self promotion activities that were required to be authorised by the franchisor). A gross annual sales turnover of $1M would result in an additional $20,000 per annum required to be expended

by the franchisee on self-promotion, which my business simply didn't have.

This facility was touted as being voluntary. The introduction of (i) above, I believed, forced franchisees to utilise the facility.

Additionally, withdrawing from this facility incurred the penalty of being unable to participate in promotions or receive rebates or other benefits for promotions, yet still be required to contribute to the marketing fund for the duration of the promotion.

Furthermore, an administration fee was payable to the franchisor which was included in the invoice price of goods supplied either as $0.xx per kg on some goods or a % of the invoiced price for other goods. Additionally, there was a non-interest bearing $5,000 'security bond' payable to the franchisor.

In deciding on whether to withdraw from this facility, I contacted a supplier to ascertain what price they could sell me the product required. I presumed it would be cheaper as there would be no supplier rebate or administration fee payable to my franchisor on my purchases. The supplier advised me that they could not reduce the price because of the arrangements they had with my franchisor, wherein they were not allowed to offer non participating franchisees of this facility reduced prices. I cannot say whether the franchisor still received rebates from suppliers on purchases from franchisees not utilising the facility.

This facility in its concept has very real advantages for the franchisee in that it eliminates the need to pay cash on delivery and spend valuable time reconciling invoices and paying suppliers. However, the franchisor reserved the right at all times to cancel the facility without having to give reasons for its action to the franchisee and would not be liable to the franchisee for doing so.

In addition to not advising in their cover letter the above changes, they also did not advise that their reprocessing fee (originally called an administration charge) on dishonoured direct debits had increased to $100 from $30.

One can argue that it is the franchisees responsibility to thoroughly read the disclosure document, which I believe it is.

But the franchisor needs to be consistent in their advices. Either not advise any or advise all changes. Only advising one or two may give some the illusion they are 'doing the right thing' and may result in the 'time poor' franchisee not checking the document as thoroughly as they should.

3.3.4 Disclosure of alterations to Agreement on Assignment

(i) Where the site/location is an existing franchised

business, the franchisor to disclose any alterations, insertions, deletions of the franchise agreement being entered into by the prospective franchisee to that Agreement of the exiting franchisee; and

(ii) Where the site/location is an existing franchised business, the franchisor to supply the prospective franchisee with a copy of the exiting franchisee's agreement.

The results of the due diligence investigation could be said to be flawed without being aware of any alterations from one agreement to the next, particularly in regard to any new fees and charges.

It is highly probable that the prospective franchisee would assume that a particular fee or charge detailed in their proposed agreement was also payable by the previous franchisee, when in reality it was not. Financial statements are produced in varying formats and may 'group' fees and charges as one total. Therefore, a new fee would not be easily recognised as not having been payable by the previous franchisee. This may impact on the new franchisee's financial viability.

Additionally, I query the legitimacy of altering a franchise agreement that has part of the "term" remaining to run following the sale of the business to another franchisee.

3.3.5 Disclosure of Details of Store Refit/Refurbishment

The Franchisor to disclose the nature and extent of any store refit/refurbishment that is required to be undertaken by the franchisee [xx] months from the date of signing the agreement, for example:

(i) estimated cost including itemised details of such work including the cost of any security requirements
(ii) estimated 'down time' of business
(iii) estimated cost for consultancy fees of the franchisor, master franchisee or other associate *(where applicable)*
(iv) any rebates, in cash or kind, to be received by the franchisor, master franchise or other associate, from suppliers or others involved with the refurbishment
(v) plans to change the corporate image of the franchisor that may significantly impact on costs of the store refit/refurbishment including any requirement to purchase new uniforms, signage etc
(vi) shopping centre contributions, if any
(vii) details of schedule of payments
(viii) Allowable variation on cost, in line with market forces, for example +/- 15% within 12 months or 20% if in second 12 months

It may appear unreasonable to request such information from the franchisor, but one must bear in mind that the franchisor

professes to be the 'expert' and quite possibly has overseen many refits and should be familiar with the intricacies of such work. Additionally, I would expect that a change in the corporate image would take some time to plan and consolidate the details and doesn't happen overnight.

The benefits to a prospective franchisee are obvious. I enquired about the store refit that was due in November 2004 to be told by the master franchisee "don't worry about it, they (the shopping centre) can't make us change much as we have a corporate image".

You can only imagine my horror when the extent of the refit was unveiled to me in 2004, with an estimated resultant cost of $100,000+.

3.3.6 Franchisor's Future Plans

The Franchisor to disclose future plans regarding any decision for the sale of the System or part thereof, float or expansion etc.

3.3.7 Prohibition on Exit/Assignment Fees

It could be said that the franchisor could be seen to be somewhat opportunistic in charging this fee, unless it could be justified, for example, in actively promoting the sale of the franchised business. If this should be the case, the fee charged should be no higher than the prevailing broker's/selling agent's commission of that State or Territory in which the franchised business is located.

Additionally, one could argue that an exit fee does more to advance the notion that there is more incentive for the franchisor to 'encourage' the departure ('churn') of franchisees on a consistent basis.

Example:
An exit fee charged at 2% of gross sales turnover of the preceding 52 weeks prior to the date of assignment, with total gross sales turnover for the period being $1,300,000 would yield the franchisor/master franchisee $26,000.

In addition to this fee, should the franchisor not actively be engaged in the sale of the business, the franchisee may also incur a brokers/selling agents fee; purchase of equipment/uniform imposed on them by the franchisor to enable settlement to proceed. It would not be unreasonable to estimate the total costs of exiting the System to be in the vicinity of $40/50,000.

Whilst $26,000 may not appear to be a large amount to some, one has to look at the broader benefits to the franchisor. Take a mature franchise system of say, 100 sites. Each site has a franchisee turnover rate of say, 3 every 10 years and an average exit/assignment fee of $20,000, based on a $1M sales

turnover figure. This scenario would yield a franchisor over a 10 year period, $6M over and above the revenue collected through franchise fees.

One also has to remember each site would have had an initial franchise agreement fee and a renewal fee generally due at the 10 year mark. Additionally, a franchisee training fee would be incurred for each new entrant (be it the exiting franchisee or incoming franchisee being responsible for the payment of the fee).

4. THE AUSTRALIAN COMPETITION & CONSUMER COMMISSION

(i) Last year, Graeme Samuel, chairman of the ACCC, acknowledged on radio that "churning" exists in Australia.

> *"Yes, we have discovered that it does exist in some cases and we will take steps if we can to deal with that. I don't think anyone can realistically deny that there are some rogue operators out there in the franchising world. It would be silly, it would be putting your head in the sand to suggest there are no rogue operators. Of course there are."*

For the chairman to make such a statement publicly, one would have to presume he has evidence of this despicable conduct.

On the same radio station around the same time period, Richard Evans (then from the Franchise Council of Australia) stated that churning does not exist because it is illegal.

If 'churning' is illegal and the ACCC have discovered that it does exist, the question then has to be asked of and answered by the chairman "why hasn't there been any prosecutions?"

Further, on discovering the existence of churning, did Mr Samuel report the ACCC's discoveries to The Treasurer, the minister in charge, or was he hoping that the proponents of franchise reform quietly fade into the distance?

It would be naive to assume that the process of "churning" is limited to those systems with poor franchisor management. Submissions presented to the Inquiry will undoubtedly indicate this practice is being undertaken by some of the more prominent brands.

The rogue franchisors have been around for some time and have recognised that the ACCC will not respond adequately to complaints from current or former franchisees.

These rogues are aware many former franchisees are financially drained and/or emotionally and psychologically 'broken' from their franchise experience which prevents them from mounting formal litigation.

Furthermore, they may have exiting franchisees sign a Deed on exiting which includes a waiver/release which releases the franchisor from claims, demands or actions against the franchisor, which in effect is depriving the franchisee of his/her right to justice.

In essence, the rogue franchisors have been getting away with it for years without fear of intervention or prosecution from the Regulator of this industry sector.

Churning takes on different shapes and forms. In addition to those which have been described in the media over recent months, it is also used to exit franchisees that have the grit to stand up to their franchisor on issues of concern. Therein begins a regime of bullying, intimidation and harassment to psychologically break their franchisees into submission. The franchisee feels trapped and the only escape is to sell or walk away. The latter generally results in the franchisee being paid a pittance by their franchisor for their plant and equipment only.

The exiting franchisee is invariably labelled a 'bad operator", a new unsuspecting franchisee enters and the cycle begins again.

(ii) The ACCC's publication "Franchising Code of Conduct Compliance Manual for Franchisors and Master Franchisees" page 46 and published 03/08 under the heading "Investigations" states:

> *"Although the ACCC records and assesses every complaint it receives, not all complaints are pursued. The information obtained from individual complaints is recorded on the ACCC's complaints database and may be used to establish a pattern of behaviour by a particular industry participant or part of an industry.*
>
> *The ACCC gives priority to matters of complaints that:*
> - *Show a blatant disregard for the law*
> - *Will cause significant public detriment*
> - *Provide outcomes that will have educational or deterrent effects*
> - *Include unconscionable conduct against small business*
> - *Will clarify the reach and meaning of the Act*
>
> *The ACCC is likely to direct disputes to the Mediation Adviser at the first instance. However, if an industry participant has blatantly disregarded the code, the ACCC may take immediate action."*

If at all appropriate, could the Committee, based on the ACCC's own publication, seek an explanation from Mr Samuel on the following?

1. I was told by the ACCC that a case could only be assessed on its own merits. I asked why when several others from the system had complained of similar conduct, therefore, a pattern of behaviour could obviously be identified - I was told that it couldn't be done. Bullying and intimation is more often verbal which would require the establishment of a pattern of behaviour.

2. When I said to the ACCC I thought a few more former franchisees would be submitting complaints, they responded that they wouldn't be able to handle the complaints from too many more that came forward.

3. I was told unconscionable conduct is too difficult to prove as if implying that I would be wasting my time unless I had a mountain of hard copy 'evidence'. It would appear that this statement by the ACCC is a contradiction of what is written in their manual. That is, "*the ACCC gives priority to matters of complaints that include unconscionable conduct against small business".*

4. I have been told by the ACCC that unconscionable conduct results in trading losses. Yes it can, but one can be the victim of unconscionable conduct by way of bullying, intimidation and harassment and still make a profit (just imagine what the profit could be without being subjected to this type of conduct). Should they be presented with a complaint where a franchisee is making a profit, will they use this as an excuse not move forward with the complaint?

Assessing compliance or non-compliance of the disclosure provisions of the code is the easy stuff. But actually having to do some investigative work and research their own database to see if similar complaints have been lodged – well it appears, based on what I was told, they are not

even aware they have the authority to carry out this comparison and make informed assumptions from information from within their own protocols to facilitate further investigation.

The ACCC are vigorous exponents for the need for education in the franchising sector. So let them be the educators but handover the responsibilities of regulation and enforcement to a body that can execute these duties diligently with competence.

5. MEDIATION

In June 2008, Mr Don Randall MP (Member for Canning) introduced the following Notice Paper into Parliament which was discussed in the Main Committee on 01 September 2008.

> *To move—That the House:*
>
> *(1) recognises the severe financial distress and hardship faced by a number of current and former franchisees throughout Australia as a direct result of franchisor conduct;*
>
> *(2) acknowledges that franchisors must be held accountable for their unconscionable conduct, including non-disclosure, through a more stringent and determined application of existing Trade Practices legislation;*
>
> *(3) notes that there are many franchisees that have no adequate or available means to redress their grievances without recourse or expensive and often unaffordable litigation; and*
>
> *(4) considers the introduction of provisions, similar to those available in industrial relations legislation, for mediation, conciliation and arbitration, at no cost to the franchisee. (Notice given 4 June 2008.)*

Although I believe the 'at no cost to the franchisee' mediation, conciliation and arbitration proposed is a sound suggestion and should be rigorously pursued, I personally have little confidence in the current process of mediation.

In reality, for mediation to have any chance of succeeding ALL parties need to come to the table 'in good faith' – something I feel was sadly lacking on my former franchisor's and master franchisee's behalf during my mediation experience.

The mediation was initiated by my former franchisor and master franchisee in their Notice of Dispute of August 2007 (some 23 months after I walked out of my store).

I received the Notice of Dispute which was dated 8 working days following the meeting requested by Mr Graeme Edwards (former Member for Cowan) in an attempt to finally get the issues resolved.

The meeting was attended by Mr Edwards, two of his staff; two representatives from the office of (*former*) Sen. Ruth Webber; my former franchisor's CEO and master franchisee (x2), myself and another former franchisee also in dispute with them. Earlier the same day another meeting was held between the franchisor's CEO, master franchisee, two former franchisees, a current franchisee and the National President plus his associate from the NFIB at Mr Don Randall's office.

Needless to say, nothing was resolved during the meetings. Subsequent to these meetings I and two other former franchisees who attended these meetings were individually issued with Notices of Dispute, all along similar lines.

The main problems I see with the current mediation remedy are:

1. There are no checks and balances in place to ensure the parties are adhering to any resolution agreed.

2. What happens if the conduct or issues that brought about the mediation in the first instance, continue? Does one then have to go through the mediation process again or challenge them through costly legal channels?

3. There is the issue of an imbalance of power weighted in favour of the franchisor, particularly if one is still in the franchised business. The character of some franchisors could leave a franchisee thinking long and hard before going down this path – I believe, there could be a real fear of what retribution would be meted out as a consequence of going up against them.

4. What does one enter as discussion or evidence into mediation? As a result of the following clause in the franchise agreement [in particular (c)] which no-one I sought clarification could categorically answer, I had some trepidation as to what to submit at mediation so as to not prevent it from being used in the future, if necessary:

> *The parties acknowledge and agree that in any mediation:-*
> (a) *everything that occurs before the mediator will be in confidence and closed session;*
> (b) *all discussions will be without prejudice;*
> (c) *no documents brought into existence specifically for the purpose of the mediation process will be called into evidence in any subsequent litigation by either party; and*
> (d) *the parties grant the mediator immunity from any liability arising out of the mediation.*

Could it be assumed that a franchisor may initiate mediation with no real intent of resolving the dispute? What then is their intent? It may be possible, under these circumstances, to come to the assumption that mediation is instigated as a 'fishing exercise' to ascertain the level of documentation and/or evidence that a franchisee may have compiled? Additionally, could it be possible for a franchisor to use clause (c) above to prevent said documentation/evidence from being used in the future by the franchisee?

Any measure to reduce or eliminate the costs of dispute resolution on franchisees is welcomed. From discussions with others, the overwhelming opinion is that mediation is a waste of time. Therefore, substantially reduced or even eliminated costs of arbitration/litigation would be more beneficial for 'cash strapped' franchisees.

Previously I had been told it would cost $100,000 just to get the case to Court. More recently I was advised that this figure was somewhat conservative and a figure of $300,000 would be more realistic. Then of course if one was to win, there would be the inevitable appeal by the franchisor resulting in an insurmountable increase in costs for the franchisee – the reliance on the probability of an 'appeal' in this scenario was confirmed by my former master franchisee.

Perhaps if all 'actions' mediations were required to be disclosed it may induce the franchisor to be more committed to the process of resolving disputes before they got to such a stage that required costly legal intervention. If it were shown that a 'system' had a high number of disputes, it would not bode well in advancing the franchisor's propaganda of a 'reputable and proven' system. Also, it could alert potential franchisees to a possible inherent or systemic problem in the franchise system.

6. WHAT HAS HAPPENED TO FRANCHISEES?

There are a myriad of experts, business advisors and commentators espousing the virtues of the franchising sector. One only has read a few of these articles or survey results to realise rarely do they quote franchisees. But where do they glean their information and 'facts'? The franchisors? The Franchise Council of Australia? Why does it appear that they rarely speak with those at the coal face of franchising – the franchisee?

I suspect they do not want to hear the sordid details which, if acknowledged, will contradict what they have been postulating for years. That is, that generally everything is fine and dandy in a sector which is growing from strength to strength. But when a franchisee has the fortitude to speak out about the injustices or lack of profitability, they are labelled as whingeing 'bad operators' who have inflicted their woes upon themselves through not undertaking adequate due diligence.

Recently an article appeared in an online business magazine which raised the question of what happens to franchisees when the franchisor collapses. My online response to that question was:

> *"While statistical information is often reported about franchisors, the comment "what then happens to the franchisee" in relation to collapsed franchise systems, should sound alarm bells. Not only is there no information on franchisees of collapsed systems, there is no statistical data on franchisees in general.*
>
> *There are no responsibilities placed on franchisors to report to a statutory body when businesses within their systems are sold, terminated, "abandoned" or otherwise. Yes, they are listed by category in the disclosure document, but are they categorised correctly? Who is checking the legitimacy of the disclosure document?*
>
> *Franchisors and their advisers have cried that additional reporting responsibilities will have a cost attached to them.*
>
> *In this case, the alternative then would be to have the exiting franchisee complete a mandatory report to the relevant statutory body on exiting the franchised business. Information could be entered on a database with statistical data and trends extrapolated annually, or as required, and reported to Government. It could identify particular trends in franchising in general and system specific conduct and behaviour. The information could also assist those contemplating buying a franchised business and form part of the due diligence process. No cost to the franchisor – but would the franchisor want franchisees doing such reporting? Highly unlikely.*
>
> *Franchising is reported as a $116+ billion industry sector, but there is no reliable identifiable data on the 'foot soldiers' who generate the income stream for their franchisors. What has actually happened to the thousands of franchisees over the years? It's an interesting question."*

May I suggest to the Committee that a feasibility study of the merits and logistics of such a reporting regimen be undertaken.

One such possible scenario could be that a pre-printed standardised reporting form, printed by the relevant statutory body authorised to regulate the franchising sector (be it ASIC, Ombudsman or similar), be distributed to the franchisors for dissemination to franchisees with any documentation that is required to finalise the assignment of the franchised business. A mandatory date of return would need to be implemented to ensure timely return of the information so that data integrity is not compromised through lengthy time lags – for example, within 14 days from the signing of the Deed of Settlement.