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# **FRANCHISE REDRESS**

## **SUBMISSION**

**The operation and effectiveness of the  
Franchising Code of Conduct**

**May 2018**

We had hoped to put in a more comprehensive submission to this inquiry, however we did not anticipate just how many distressed franchisees would reach out to us. They were from over 40 brands. This was naturally all consuming for us. One of the biggest themes for discussion was fear of franchisor retribution when it comes to existing franchisees. Even though it could be seen as a contempt of parliament to retaliate against a franchisee for putting in a submission, franchisors have subtle ways of exacting revenge which is hard to detect. Franchisees are acutely aware of this and can find themselves being terminated shortly after by failing store cleanliness audits etc.

## Investigating Corporate Misconduct

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Franchise Redress was co-Founded by Michael Fraser and Maddison Johnstone in 2017 after observing systemic abuses in the franchising industry.

These observations were formed when

- Michael helped expose systemic wage fraud at 7-Eleven stores across Australia, leading to over \$150 million in backpay to over 3600 workers (as of February 2018),
- we travelled Australia investigating Domino's Pizza in early 2017 after a number of franchisees raised concerns about the profitability of their stores. They made contact with our office after 7-Eleven's misconduct was exposed, and
- investigating complaints and tip-offs that Retail Food Group were strategically milking franchisees of their last dollar, with many becoming financially destitute.

We endeavour to represent the issues and concerns in the franchise industry as a whole, and do not purport to side with just franchisees or franchisors. At this stage, mostly as a result of Retail Food Group's misconduct being exposed, we have been contacted by franchisees from over 40 brands - some of them groups of franchisees - with issues varying from fee gouging, the sale of stores that repeatedly failed and franchisor bullying.

### Objectivity

It is important to note that when investigating corporate misconduct, one must remain objective. To be open to the idea that a franchisor or representative would engage in misconduct, you must also be open to the idea that franchisee may not have clean hands.

In the case of 7-Eleven, there is overwhelming evidence<sup>1</sup> that head office were aware of systemic underpayment throughout their store network, yet when the media hit, management responded by denying they were aware.

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<sup>1</sup> <https://www.aph.gov.au/DocumentStore.ashx?id=bb51ccc6-384d-4dad-8557-2fe753507ed8&subId=402821>

It then became clear that many franchisees were struggling to make ends meet under the current franchise agreement, and this gave rise to circumstances where the underpayment of vulnerable workers occurred.

However, this does not automatically make everyone at 7-Eleven 'the bad guy', nor does it make every franchisee a 'victim'.

In relation to this inquiry and any submissions made by 7-Eleven or their franchisees, we must remember that the almost billionaire owner and former chairman of 7-Eleven, who profited for decades while underpayment occurred, is still the owner. The current chairman also sat on the board for over a decade while systemic underpayment occurred.

As for the franchisees, some of the loudest franchisee voices complaining about profitability and taking action against the company to avoid paying large sums of unpaid wages are the same ones who confiscated passports from vulnerable workers, made them hand over their bank cards and left them without money for food. They own expensive cars and some own multiple luxury properties.

To address issues, it is important to understand the problems on both sides, and cut through agenda, opportunism, misconduct and to get to the heart of the real problem.

### **Brand Proliferation**

The number of examples is growing whereby franchise networks are increasing in size by allowing for, conveniently overlooking, or relying on underpayment of vulnerable workers to strengthen the viability and profitability of their brand network. Given the current environment with media interest, stricter laws, larger penalties and more vigilant regulators, it is astounding that any company has the audacity operate in this fashion. But it is happening.

These issues appear to be more prevalent where a company is publicly listed, is considering going public, has private equity, or is looking for private equity.

Note: Where there is underpayment of vulnerable workers, often from Asia and the Indian subcontinent, there is also a good chance that illegal sponsorships are taking place in the network.

Craveable Brands, who owns Oporto, Red Rooster and Chicken Treat recently attempted to become a public company. Our office received intel to suggest there were network underpayment issues and franchisees were struggling to make a profit.

United Petroleum is said to be as bad as 7-Eleven, and our preliminary investigations would suggest there are systemic underpayment issues, with franchisees also struggling.

Pie Face, now owned by United Petroleum, also has underpayment issues based on discussions with workers in our store visits.

Guzman Y Gomez is growing at a fast rate and is now seeking investment from private equity, perhaps then they will list as a public company. We observed an interesting pattern of stores with seemingly too many workers on shift, who all happened to be foreign students from the same part of the world. When we asked about their wages, just as with 7-Eleven, it appeared they were instructed to say they are not allowed to discuss their wages. When speaking to people who have friends working in those stores we were told “they are being paid properly on TFN”, but when we asked if they received overtime, penalty rates etc, we were told “no no no, but they don’t mind so it’s ok”.

Grill’d have franchisees, however we have recently spoken with staff from various corporate store locations who have told us that they are expected to work a certain number of free hours in exchange for free food and soft drink during those hours. The most common example of this was being asked to stay back and work for a few hours and clean unpaid.

Note: The former CEO of Grill’d used to be the CEO of recently collapsed Aussie Farmers Direct and is now Chief Acquisitions Officer at 7-Eleven.

Metcash have IGA. On a number of occasions we heard that after the 7-Eleven wage scandal erupted, franchisees were buying IGAs, or using their IGA’s to underpay their 7-Eleven workers. This was facilitated by paying their 7-Eleven workers the legal wage whilst working in their 7-Eleven store, then instructing the worker to carry out a number of shifts in their IGA for free. We have also heard that IGA’s are commonly used to sell sponsorships.

Note: The new Retail Food Group CEO for Australia was the General Manager for Queensland and Northern NSW at Metcash from July 2015 - January 2018.

Lucky 7 is also part of Metcash. Lucky 7 does not appear to be sold as a franchise, but has many similarities to a franchise system. We have heard of the underpayment and sponsorships of vulnerable workers in this business as well. By not labeling this brand as a franchise it may not be subject to the same scrutiny and regulation of a franchise system.

Harvey Norman refer to their partners as franchisees, but may not be subject to the same scrutiny of a franchise system, given that they may not technically be classed as a franchise.

Although we are not hearing complaints from franchisees, this model appears to be designed to avoid the true wage obligations that Harvey Norman might be subject to by declaring them as franchisees - who work long hours, as opposed to store managers. When looking at the system, partners closely resemble employees, and if they are franchisees, we question if some of the practices would be a breach of the franchising code.

Caltex were happy to grow their brand and the size of their network at the expense of the franchisees. Like 7-Eleven, the viability of their stores has come into question. When franchisees have to make a choice between providing for their family and paying their workers, underpayment ensues. Not only did Caltex grow their brand and benefit from a questionable model, they also benefited when they were exposed. By terminating franchise agreements for underpayment of workers, it enabled them to take stores back without making any goodwill payment. In place of referring the matter to the Fair Work Ombudsman and buying the stores back or allowing the franchisee a period to sell, they chose the option to strip the franchisee of their investment. It may be legal, but does the punishment fit the crime and were Caltex complicit?

## 7-Eleven

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The case of 7-Eleven is quite interesting and has been the subject of many industry discussions, various academic studies<sup>2</sup> and a manuscript published by Griffith Journal of Law and Human Dignity<sup>3</sup>.

To our knowledge, 7-Eleven's systemic underpayment of vulnerable workers was the largest in Australian history, with over \$150 million paid back to over 3,600 workers. The fact that 7-Eleven established a backpay program and paid so much to the workers has been praised by many. There was no legal requirement for them to do so, and the Fair Work Ombudsman's investigations could not prove that 7-Eleven were complicit and liable for franchisees underpaying their workers.

To use an analogy: Let's consider if the Royal Commission into Banking heard evidence that a bank made \$1 billion over a 20 year period by gouging a high percentage of the fees meant for the broker network, operating under their financial services licence, who in turn underpaid their staff to survive.

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<sup>2</sup><https://www.mwji.org/highlights/2017/11/14/report-released-wage-theft-in-australia-findings-of-the-national-temporary-migrant-work-survey>  
[http://law.unimelb.edu.au/data/assets/pdf\\_file/0008/2694995/Berg-and-Farbenblum-413-Advance.pdf](http://law.unimelb.edu.au/data/assets/pdf_file/0008/2694995/Berg-and-Farbenblum-413-Advance.pdf)

<sup>3</sup><https://griffithlawjournal.org/index.php/gjlhd/article/view/836/816>

Then the Royal Commission finds that the bank acted lawfully, but unethically and likely to have caused significant financial strain to the brokers that lead to underpayments amounting to around \$1 Billion.

Would the bank be worthy of praise for returning 25% of the \$1 billion to the workers, and keeping the rest to buy mansions and private jets for themselves? Then imagine that the Chairman stood down, but remained involved in decisions involving the backpay program. Imagine still, a fellow board member who sat on the board for almost two decades, being promoted to Chairman to address the issues.

They sack the CEO, but continue to have a strong influence over how much money is paid back and the direction of company going forward, including commercial decisions. If they told the Royal Commission they learned their lesson and were the right people to fix the problem, would you be comfortable with that?

At the time of the 7-Eleven scandal breaking, we estimated the underpayments at 7-Eleven were around \$80 million per year across 620+ stores. Averaging at around \$2,500 per week, per store (service station), based on only one worker being on at any time, being paid \$12 per hour and not working overtime. Other modeling suggested it could be as high as \$150 million per year. Workers have contacted our office claiming that underpayments were happening back in the 90's.

The fact is, thousands of current and former 7-Eleven workers did not make a backpay claim for one reason or another. And when 7-Eleven decided to decommission the independent Fels backpay program and take it in-house, our office received many calls from claimants who were concerned that 7-Eleven were offering them much less than they were entitled to. Many were desperate and had no money, so they felt they had no choice but to accept the low offer as full and final payment.

The true extent of the backpay at 7-Eleven will never be known, nor will we know how much financial benefit 7-Eleven and owners received as a result. What we do know is [REDACTED], the owner, would not almost be a billionaire and perhaps not even a millionaire.

## **Franchisees**

How 7-Eleven treated the franchisees post-exposé was telling of their culture and the imbalance of power between franchisees and franchisors. As a result of media pressure and franchisee pressure, 7-Eleven decided to adjust the profit split and issue a new franchise agreement. It increased the franchisee profit share and added stricter guidelines around franchisee obligations in relation to wage laws.

What you may not have heard about was how 7-Eleven got the franchisees to sign the new agreement, despite many not being happy with it. Our office received numerous phone calls from concerned franchisees claiming that 7-Eleven sent District Managers out to their stores with the new franchise agreement pressuring them to sign it or they would not receive ongoing support. A handful of franchisees said they were told they were the only person remaining who had not signed the new agreement, adding further pressure for them to sign. This was not the case at the time as many were yet to sign. They knew they had no option but to sign, or their franchise agreement would not be renewed when the time came.

Despite the company's efforts to issue backpay, stop underpayments and remove franchisees doing the wrong thing, underpayment of vulnerable workers at 7-Eleven is still a problem.

Yes, things have improved and quite a few workers have contacted us to say how happy they are that they are finally being paid properly and don't have to pay any money back. That is great.

However, we still regularly receive intel about underpayments in the network, with workers having to pay cash back being the main issue. When the intel is usable we pass it to 7-Eleven and have to trust that they act on it.

A possible challenge 7-Eleven has in terminating some of the multi-site franchisees (known in the network for being some of the worst for mistreating and underpaying their staff) is rumours that they claim to have evidence that shows head office were complicit, including the owner. It appears to be a case of, 'if I go, I'm taking you with me'. We did hear that in one case they allowed the franchisee to slowly sell off all their stores. This may have avoided termination. We have not had the time to follow up on this information, and it may be completely misinformed, but we have little reason to doubt our sources. We have included this information so the committee can ask the company about it directly.

Even though 7-Eleven has improved and to a large degree taken responsibility for the underpayment scandal, we feel they have only done so because they were caught with their metaphorical pants down. If this is not a case of incompetence, ineptitude and collecting money with blinkers on, then it must be a case of cold, calculated white collar crime.

## Domino's Pizza

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Domino's first came onto our radar when workers claiming to be underpaid and disgruntled franchisees made contact with our office shortly after 7-Eleven were exposed in late 2015.

A particular issue of concern was franchisees from the Indian subcontinent claiming they were racially targeted for wage audits as a result of the 7-Eleven revelations. On Friday 2 October 2015 Michael met with Domino's CEO [REDACTED] and raised underpayments and wage audits.

[REDACTED] was very polite, receptive and open to addressing any underpayment matters. He did however become quite agitated and defensive when asked if the Indian community of franchisees had been targeted for wage audits. He denied it happened and claimed that wage audits had been in place for years and were routine.

On or around 12 January of 2017 we sent an email to a number of Domino's franchisees with a list of questions about being a Domino's franchisee. The goal was to determine if Domino's franchisees were struggling to make a profit, and if there was any indication that underpayment issues were systemic.

It was important for us to ask these questions to ensure we had an accurate data sample concerning the issues raised. On or around 12 January 2017, we commenced store visits around Australia. Gold Coast, Brisbane, Melbourne, Adelaide, Perth and Sydney.

Around that same time, we heard that Domino's had reminded their franchisees of their obligations not to speak with the media and people like us.

On 16 January 2017 the CEO [REDACTED] sent out an email - called a [REDACTED] NOTE - that contained photos, was misinformed and had Maddison confused with someone with whom we were aware of, but not associated with.

Extract: *"THIS DOCUMENT IS COMMERCIALY-SENSITIVE AND IS HIGHLY CONFIDENTIAL TO DOMINO'S PIZZA ENTERPRISES LIMITED ("DPE"). THE INFORMATION IS INTENDED FOR DPE SENIOR MANAGEMENT, AND ITS FRANCHISEES. IT IS NOT TO BE PROVIDED TO ANY THIRD PARTIES, INCLUDING ANY OTHER DPE EMPLOYEE, EMPLOYEES OF FRANCHISEES, WITHOUT THE EXPRESS AND ADVANCE WRITTEN CONSENT OF THE CHIEF EXECUTIVE OFFICER. THE INFORMATION IS PROVIDED ON THE BASIS THAT IT IS CONFIDENTIAL AND IS GOVERNED BY THE CONFIDENTIALITY PROVISIONS OF THE RELEVANT DPE EMPLOYMENT*

*To all Franchisees and Operations Managers,*



*As many of you are aware, an email was sent to the system on Friday by a Michael Fraser calling himself "The Arbitrator" (see photo attached). Since Friday, some stores have had their drivers cars leafleted by Mr Fraser...Both of these individuals are disguising them as wanting to help Franchisees and Team Members. There is also some confusion that they have been approved to be doing this soliciting by DPE.*

*Let me make it clear. Neither person has been approved by DPE to solicit you, and neither party has any intent on helping Franchisees or Team Members. We have previously met with Mr Fraser. He shared he was aware of Team Members in Domino's not being paid correctly. We openly asked him to help us with stores or names so we can go about making sure this was corrected.*

*We have a zero tolerance to under payment of our team members and would love to make sure they are being paid correctly and anyone intent on continuous underpayment should be removed from our system. Mr Fraser gave us a reassurance he would supply contacts, and never has."*

Interestingly, despite being acutely aware that speaking with us could constitute a breach of their franchise agreement, a small number of franchisees wrote to us around the same time speaking highly of the company and the management team. They told us that the CEO [REDACTED] had no problem with them speaking to us.

As we travelled around Australia we met with some of them to hear their happy stories. What became apparent was that they were more interested in getting the names of the unhappy franchisees who were speaking to us. Of course we never told them. In each case we had a strong suspicion that they were recording our conversation, especially when they were sliding their phones across the table in our direction. The other obvious theme with the happy franchisees who met with us, was they all seemed to be on reduced royalties or were one of the 'favourite franchisees'. Each of the 'favourite franchisees' that we met around Australia all had the same lines of questioning. Our guess was that they were trying to weed out who was speaking to us and pass the details on to management.

It was our feeling that the CEO [REDACTED] was driving the agenda from behind the scenes. Some potential evidence of this presented itself when we were in Sydney. A franchisee named [REDACTED] responded to our email questions.

*Extract: "Hi Michael,  
I have received your below email from my fellow franchisees whom you contacted to join your money making venture as you are the very same person who let many 7 Eleven franchisees bankrupted and many employees lost their jobs but you made yourself well off from which you ended up living in Gold Coast - world's holiday paradise destination.*

*I am quite surprised and meanwhile I don't understand what has made you to think of Domino's as we franchisees have gone through some hard days of disagreement with head office but along the way with great leadership we made this company very successful and achieved what we were even not dreaming about ( the sales we do now ).*

*[REDACTED] in last 15 years, I have never felt I was forced unlawfully against my will as I always shared my disagreement with head office over any issues whenever I felt something is not correct we stand up and questioned the head office and we have resolved the issue in a very logically acceptable manner.*

*Domino's Australia Business Role Model has made us the best successful company in the QSR market by improving daily in how we serve our customer better than yesterday which made us ahead of our competitors.*

*Please note that we are not 7 Eleven but a team of very hard working franchisees and Domino's Head Office Leadership team who listen to each other who believes we can even make it better.*

*Please see below highlighted information in reply to your Questions:*

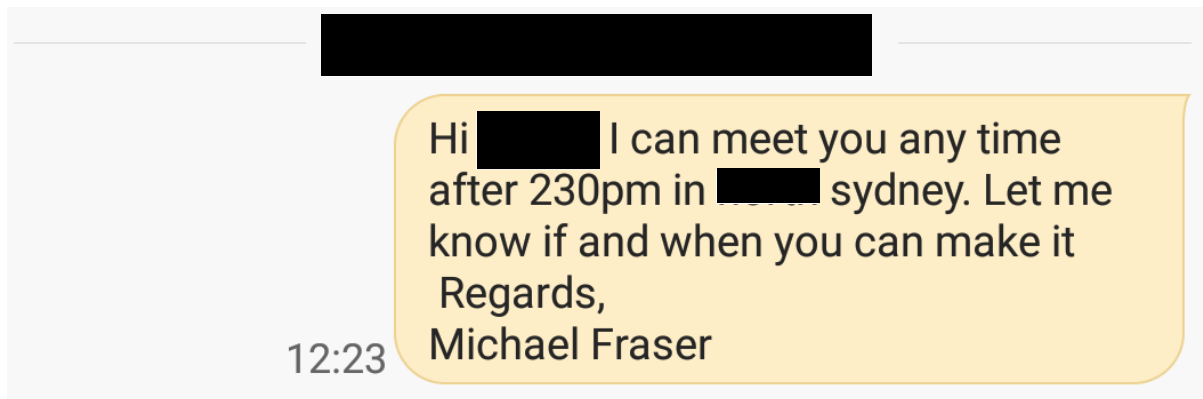
*And to make your job easier I copy every single franchisee in Australia to prove to you we are not in 7 Eleven Situation you thought...*

*...Please noted : Any damage to Domino's Head Office will directly affect all my fellow franchisees for which I will not have any choice but to personally sue you for it - Can you please disclose how much you made from 7 Eleven ?*

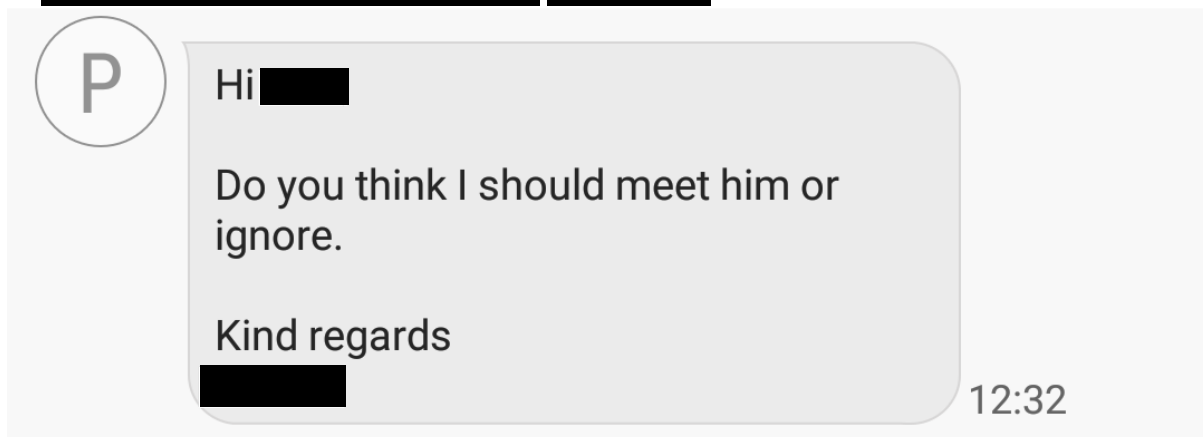
*Regards*

We sent [REDACTED] an email with the times we would be in Sydney if he wanted to meet. He replied "I can 100% guarantee you, there is not a single franchisee in Sydney would like to see you so please don't waste your time get a real job and let Domino's to do their hard work."

The next thing that happened was quite telling. At [REDACTED]  
[REDACTED] this text.



At [redacted] [redacted] replied with this rather telling text.



It was clear that [redacted] had been discussing our visit with the CEO [redacted] and seeking direction from him based on the text message we received that was meant for [redacted].

We never met with [redacted], but that night we learned why he was so concerned about our Sydney visit. It was quite serendipitous that the first store we visited was one of his. Staff were forthcoming about [redacted] routinely underpaying workers across his network of around 10 stores. We visited a number of his stores and repeatedly heard similar stories of underpayment.

We understand that Fair Work are investigating him, and there have been a number of stories in the media<sup>4</sup> with his staff speaking out about being underpaid. Domino's have confirmed this<sup>5</sup>.

<sup>4</sup><https://www.smh.com.au/business/workplace/one-of-the-biggest-dominos-franchisees-investigated-20170310-guv02y.html>

<sup>5</sup><https://qsrmedia.com.au/legal/news/dominos-releases-statement-about-wage-fraud-allegations>

Despite Domino's claiming they have a zero-tolerance policy when it comes to underpayment, it was revealed in November of 2017 that while under investigation for underpayment Domino's allowed him to begin the process of setting up a new store in Sydney<sup>6</sup>.

Why is [REDACTED] story relevant? Because [REDACTED] is a 'favourite franchisee'. He is said to be personal friends with the CEO [REDACTED] and until recently was friends with [REDACTED] on his personal Facebook account. We suspect [REDACTED] unfriended [REDACTED] after the Fair Work Ombudsman service were questioned about the friendship in Senate Estimates.

### **Pizza Checker or Pizza Spy?**

In November 2017 at Domino's Annual General Meeting, the CEO [REDACTED] announced that very soon every store would have a new piece of technology called Pizza Checker<sup>7</sup>. We were travelling Australia investigating Retail Food Group at the time, so we decided to ask Domino's franchisees what they thought. We were surprised to hear that most had no idea what we were talking about, and the ones that did, became aware because they saw the CEO talking about it on TV. We later heard that it would cost each store about \$3,000 and potentially a monthly software fee. Domino's say that it will take a photo of every pizza and use artificial intelligence to check the quality of the pizza before it goes out to the customer.

Quite disturbingly, when speaking to a number of long time franchisees, they told us that they don't believe it has anything to do with customers. They said that many franchisees are not making money anymore, so they don't declare all of their sales, and don't put them through the register. This effectively robs Domino's of their royalties. Apparently franchisees under reporting sales is a problem in the network. Franchisees say by having a pizza checker above the cutting board in every store taking a photo of every pizza is a way that Domino's can conduct surveillance on franchisees and ensure all pizzas are accounted for. No doubt Domino's will strongly refute this.

### **Sponsorships**

In early 2017, a Chinese student recorded a phone call between himself and a Domino's Pizza franchisee who had a store in [REDACTED]. The recording showed that the student was being offered a visa sponsorship if he agreed to pay \$150,000 plus legal expenses, and that he had to use the franchisee's lawyers.

The franchisee also made it clear in the phone call that he had sponsored other workers, and not just at Domino's Pizza, but other franchise brands too.

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<sup>6</sup><http://www.afr.com/business/retail/dominos-served-with-notice-to-produce-by-fair-work-20171104-gzf0dv>

<sup>7</sup><https://techau.com.au/dominos-commits-to-roll-out-pizza-checker-ai-to-every-store-in-the-country/>

Since Fairfax Media exposed the sponsorship scandal<sup>8</sup>, Domino's Pizza reportedly terminated the franchisee. However, given Domino's controls the bookkeeping of their franchisees, our question is;

have they attempted to contact this franchisee's previous workers to see if they a) paid a large sum of money to be sponsored, and b) could determine the size and severity of underpayment that would have no doubt occurred.

We have email evidence that we would be happy to supply the committee, and/or relevant government department of a Domino's 'favourite' multi-site franchisee communicating with a migration lawyer to sponsor and employ a worker by circumventing the migration rules.

The franchisee was/is in a joint venture partnership with Domino's via their subsidiary company Hot Cell Pty Ltd. The worker claimed he was asked by the franchisee to pay thousands of dollars to him to be sponsored - which is illegal - and to complete the process the franchisee needed to place an ad in the paper to demonstrate that he looked but found no suitable applicants. This is despite the fact the emails indicate it was his intention to sponsor the worker and have him fill that position.

This franchisee was also the subject of a Fair Work claim - by the same worker - for underpayment<sup>9</sup>. Domino's intervened and ensured the worker was paid back. The franchisee is said to have continued to receive favoured treatment from Domino's, continued to grow more stores in partnership with Domino's and purchased at least one other store well below market value. We are unsure of his status now, but his LinkedIn profile lists him as Operations Manager at Domino's<sup>10</sup>.

When travelling Australia, we were told by some of the happy 'favourite franchisees' that it is commonplace for franchisees to sponsor store managers. They told us the reason is because they can't find suitable locals to be store managers and therefore need to sponsor immigrants.

This was interesting to us because one franchisee in Perth told us he is paying over \$80,000 per year (we were sceptical of this amount as we have heard much lower figures) for managers and is looking to sponsor more.

We heard another 'favourite franchisee' in Melbourne CBD has three stores and sponsors managers in all of them.

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<sup>8</sup><https://www.smh.com.au/business/companies/dominos-pizza-franchisee-offers-to-sell-sponsorship-visa-20170212-gub15b.html>

<sup>9</sup><https://thenewdaily.com.au/money/work/2017/02/13/tosif-varsis-dominos-scandal/>



We asked that franchisee directly if he was sponsoring managers in his stores and his response was to give us the impression he didn't even know what a sponsorship was. He was also an immigrant.

We have heard that sponsoring store managers is more common with multi-site franchisees. Why is this a topic of concern? Well, apart from the fact that we are not convinced that franchisees can't find suitable local workers in CBD locations, there is also the more concerning issue of the exploitation of sponsored immigrant store managers.

Apparently, it is common for store managers not to sign in and out during their shift, meaning there is no record of the hours they worked in the system that all other staff use.

The sponsored store manager is paid a salary to work 40 or 50 hours a week, then is expected to work many more hours for no extra money. We have had calls from all around Australia about this, with some managers working 20, 30 or even more hours for free each week. Because they are sponsored, just as with 7-Eleven, they don't question authority for fear of losing their job.

Domino's should be conducting a full investigation into the sponsoring of immigrants as store managers. They should collate a complete list of all cases of sponsorships, current and historic. Once they have the list they should launch a fully independent investigation to determine the true extent of the exploitation.

Domino's say they have a no-tolerance policy when it comes to underpayment. From our observations it appears to be more like selective tolerance, depending on who you are.

## Retail Food Group

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Retail Food Group (RFG) is an Australian-born, publicly-listed, multi-national company. They own famous brands such as Brumby's Bakery, Crust Pizza, Donut King, Gloria Jean's Coffees, Michel's Patisserie, and Pizza Capers, along with lesser-known brands such as BB's Cafe, Big Dad's Pies and Esquire's Coffee. They also own brands in the supply chain, including Di Bella Coffee and Hudson's Pacific.

Out of all the franchise systems we investigated, we had never encountered franchisees being so forthcoming and willing to talk than we did with RFG franchisees. There was a sense that they had nothing to lose.

Many franchisees we spoke to claimed to be happy prior to their brand being acquired by RFG. This was especially the case with Brumby's Bakery and Michel's Patisserie. Franchisees were generally excited at their brand's prospects and future and were interested in becoming multi-store franchisees and investing their future in the company too, if they hadn't already. However, in 2007, RFG acquired both Brumby's Bakery and Michel's Patisserie. From here, the family culture disappeared, and franchisees told us it became all about squeezing them out of money. Their stores now had little (if any) financial viability.

A number of franchisees spoke about the culture of churn. Given that RFG have a large franchise network and a long list of well-known brands, there is always another buyer ready to buy, making churning stores a financially rewarding arrangement.

With RFG, we have heard of a number of occasions where franchisees could not sell their store, were forced to abandon it or walk out, only for RFG to come in and run it as a corporate store, and then sell it a few months later. None of the proceeds of this sale go to the former franchisee.

A number of franchisees who purchased company-operated stores from RFG, told us they later discovered that they were given 'example' financials (generally, financials that reflect the operations of a successful outlet), and not told of the history of the outlet and how the previous franchisee/s fared. One instance was where a Gloria Jean's franchisee purchased a store from RFG, and later found out that the previous three franchisees went bankrupt in that location.

During our investigation, franchisees would often theorise that RFG didn't care if their brands died. The most common theory was that RFG acquired a brand, decimated the franchisee support staff, renegotiated supplier deals and collected 'kickbacks' to the detriment of the franchisee's profit line, milked every possible cent out of the franchisees, before finally allowing the brand to die.

The franchisees' overall conclusion was that RFG was not in business with their franchise partners. Instead, they were solely in business with themselves. This theory left us sceptical as there was little commercial sense to it, however, as we travelled across the country, we spoke to many franchisees devastated by RFG's business practices.

The number of franchisees we encountered who were bailing from, battling in, or beaten by RFG's system was scandalous. Coupled with the amount of store closures we happened across, it left us with little option but to accept that this theory must be true.

Throughout their history, RFG has acquired new brands as one brand started to die. For example, as the numbers for BB's Cafe and Esquires Coffee Houses began dwindling, RFG acquired both Michel's Patisserie and Brumby's Bakery. As these brands began dying, RFG acquired Gloria Jean's Coffees.

Big Dad's Pies ex-franchisees told us that RFG acquired their brand when there were (over) 30 outlets. Ex-franchisees told us that RFG expected them to re-brand as Brumby's Bakeries, however the majority did not want to. In the eight years since RFG acquired them, there is now just one outlet.

## **Leasing**

A number of RFG franchisees told us how they bought a store in a new or refurbished shopping centre, with RFG as the Head Lessee. The centre plans were not made clear to them and they would later find a number of independent or chain cafes were set to open in or around the same time - in many cases, just metres apart. This greatly affected their ability to trade successfully, and they were suspicious as to why RFG never informed them, or in some cases misled them, about other similar outlets operating so close to their store. In one case a franchisee told us that he found out that RFG knew that eight other competing outlets were due to open within metres of his new Michel's Patisserie. His financial situation is now dire and he would never have taken the store had he known this information.

There were also instances where the shopping centre performance was beginning to decline, and RFG operated corporate stores in the centre, but still sold these stores to prospective franchisees without properly disclosing the performance of the shopping centre.

RFG franchisees on several occasions have told us the difficulties they had in ensuring RFG would be in attendance at lease negotiation meetings, or lease meetings, or any meetings with their landlord. They also informed us that they had no idea what was being said, what arrangements were in place, or if RFG were receiving some kind of rebate from the landlord.

RFG also had peculiar leasing arrangements. In order to protect the identities of the franchisees who reached out to us with concerns around their leasing arrangements, we have used generic numbering in the Company Name below.

A Michel's Patisserie franchisee told us that they were made a director (by RFG) of a company following the pattern of "MICHELS PATISSERIE 9999 PTY LTD". The person who was a director prior to this franchisee was former Managing Director and CEO [REDACTED], and then current Managing Director [REDACTED]. [REDACTED] was removed when this person signed on to becoming a franchisee.



The shareholder of the company was RFGA MASTER LEASE PTY LTD. The franchisee signed away all of their directorship rights, but they had the responsibility to pay for the ASIC registration.

We were also extremely concerned when we saw documentation from [REDACTED] Accounting that indicated this firm was facilitating these leasing companies. [REDACTED] Accounting was former RFG Managing Director and CEO [REDACTED] former accounting firm now headed by [REDACTED]. This documentation was sent to a franchisee by RFG, with a representative encouraging the franchisee to sign it, that amounted to a fake Minutes of Meetings that never occurred to the franchisee's knowledge. In fact, the Minutes of the Meetings was said to have occurred at a day and time when the franchisee was in an entirely different state to which the Meeting was said to have happened in the Minutes of the Meeting.

We are aware of a number of other RFG franchisees who have found themselves in a similar situation, but we can only speculate as to the true number of franchisees who have been impacted.

### **Aggressive Growth Strategy**

RFG's growth strategy differed from other companies - instead of growing by developing their brand through building more stores at a phenomenal rate, RFG would instead develop their company through acquiring more brands.

Like other well-known and often trusted franchise brands, their aggressive growth strategy didn't appear to factor in the impact this would have on their franchisees from existing brands. There is a store near our office where there is a Michel's Patisserie, Gloria Jean's Coffees, and Donut King about 20m apart from each other -- they compete with each other, and in the instance where a franchisee left their store and it shut for a number of weeks, one of the other franchisees claimed that this was their best trading period ever.

As what happens with a number of companies and brands that fall victim to aggressive growth strategies, underpayment was rampant in the RFG network.

A number of bakers across the Brumby's Bakery network were being paid in cash and not according to the award. One baker was being underpaid in cash by two franchisees. It was also common for bakers to say they had no choice but to come in hours earlier than their rostered start time, unpaid, as it was impossible to complete the work in their shift. This was particularly concerning as it points toward another problem of severe understaffing and bakers being expected to work above and beyond what is reasonable.

Underpayment at Michel's Patisserie outlets was rampant, mostly in the form of using family members in a volunteer capacity or severely underpaying them. One Michel's Patisserie franchisee admitted he knew it was wrong to underpay, but stressed he had no choice but to do it, as his young family couldn't make ends meet any other way. He says his wife was needed back in the store only days after giving birth, which we found distressing to hear.

A New South Wales Crust Pizza delivery driver in his mid-20's from Asia told us he was paid \$13 per hour, plus \$2 per delivery. He had no uniform, was using his own car and was illegally parked due to no parking provisions for delivery drivers.

A number of Crust Pizza franchisees told us wages of \$13 per hour plus \$2 per delivery was allowed and common practice. After meeting with a former Crust Pizza franchisee, we later found out that the franchise agreement makes allowances for subcontracting delivery drivers. The franchisee said is used as a form of sham contracting to keep labour costs down, or else the stores would not make a profit.

We spoke to a Gloria Jean's staff member who said she was paid according to a part-time award for her age bracket, but was technically a manager as she was performing managerial duties. She said she asked her franchisee to classify her as a manager and to be paid accordingly, but the franchisee told her 'things were too tight right now' and she could not afford to pay her the proper wage.

### **Australian Competition and Consumer Commission**

It is interesting to note that RFG and their associated brands had no fewer than 61 "franchise-related contacts" between 1 January 2015 and 28 March 2018. Given the company has been around since the 1980s, it is very concerning that such a high amount of contacts were made in a comparatively short period of time. Based on contact made to us by RFG franchisees, a number of these "contacts" will no doubt be group submissions to the ACCC - potentially driving up the number of disaffected franchisees even higher.

On page 4 of their submission, RFG wrote, "RFG has had various interactions with the Australian Competition and Consumer Commission (ACCC), and considers the ACCC to be a well-resourced and effective regulator".

If RFG believes that the ACCC is properly funded and effective, how do they rationalise that there was no formal, public consequence to even one of the contacts that the ACCC received?

## Marketing Funds

When conducting our investigation, one of the most common concerns franchisees raised centred around the marketing fund's expenditure. Franchisees from all of the brands we visited expressed similar concerns. Many of them had a suspicion that large sums from the various marketing funds were being used to fund numerous RFG-branded racing cars that the recently retired former CEO ██████████ had been racing for many years, and right up to the end of 2017.

Franchisees were concerned that the marketing fund audits did not indicate how much money was going to the sponsorship of racing vehicles, if at all. Further, RFG's annual reports from 2008 - 2017 made no mention of the sponsorship arrangement with ██████████, despite the fact that he continued to race in Australia and internationally using the RFG-branded race cars emblazoned with the logos of all their brands.

## People behind RFG

We quickly became aware of the impact former Managing Director and CEO ██████████ had on RFG. Under his leadership, RFG made at least 15 acquisitions valued at almost \$500 million.<sup>11</sup> His questionable conduct around the Donut King racing car, where he, his adult son ██████████, as well as his car racing team including ██████████ and ██████████, would enter and race in car tournaments apparently funded partially or completely by RFG marketing funds.

We also learned about his de-facto partner ██████████, who at one stage was the Director of RFG's Bakery Cafe Division, and who we understand still runs a Donut King on the Gold Coast. Workers at this Donut King have said to us that they have not been paid super, and there is a \$2.8 million tax assessment placed on her entity Exit 57 Investments by the Australian Tax Office<sup>12</sup>.

██████████ owns a \$5.5 million mansion<sup>13</sup> in the northern parts of the Gold Coast. Her adult children ██████████ and ██████████ also worked for RFG in various capacities. People who knew ██████████ informed us that he received a "fast promotion" to Operations Manager, despite not even understanding how a Profit and Loss Statement worked, and being only in his early twenties at the time. They informed us that there were much more qualified people at RFG at that time to perform this role but they were overlooked.

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<sup>11</sup><https://www.smh.com.au/business/companies/the-colourful-background-of-the-man-behind-a-franchise-fortune-20171208-h0180x.html>

<sup>12</sup><https://www.smh.com.au/business/consumer-affairs/rfg-s-secret-deal-to-manage-stores-under-scrutiny-20180305-p4z2xh.html>

<sup>13</sup><https://www.goldcoastbulletin.com.au/realestate/gold-coast-hinterlands-great-gatsby-mansion-sells-for-55m/news-story/48765bc64cd3b01da321399e97ccd339>

RFG conduct: Given our involvement in the exposure of RFG franchisees being impacted by a brutal model, we thought it was important to make contact with the company to share some of our insights and information gathered through our research and investigations.

Investor and Public Relations Manager [REDACTED] informed us that she was to be our contact and we were to put any communication through to her. We emailed her and asked her:

“To ensure we have the correct information when speaking about RFG, could you please tell us the exact number of stores currently trading in Australia on a per-brand basis for the following brands? Donut King, Brumby's Bakery, Michel's Patisserie, Gloria Jeans, Crust Pizza, Pizza Capers, Cafe2U, The Coffee Guy, Big Dad's Pies, Esquires, and bb's cafe.”

We received no response.

We also emailed RFG's new CEO of Australia [REDACTED], hoping to offer insights and discuss the problems we are hearing about from franchisees, however we did not receive a response.

On two separate occasions, RFG refused to allow franchisees to attend meetings with us as their support people. The General Manager of Donut King [REDACTED] told one franchisee on/around 11 December 2017,

“In any event, I note you would like an advocate from Franchise Redress to join you. Michael Fraser is an individual who has been the subject of complaints from our franchise partners in terms of his conduct and we would not entertain any dealings with him or any of his associated parties.”

The franchisee asked for evidence of their allegation. None was provided. Plus this is quite strange, considering Bakery Cafe Director [REDACTED], who has now left the company, used vastly different language on 24 November 2017 (after the majority of our on-the-road investigation had ended) in an email to franchisees,

“Some of our Franchise Partners have advised us that they are being approached by a gentleman named Michael Fraser, who is asking for information about their business relationship with Retail Food Group (RFG) and matters relating to recent amendments to the Fair Work Act.”

It is important to note that at no point during our investigation were we asked to leave a store by any franchisee. We conducted store visits together and at no point did any franchisee appear frustrated or bothered by our presence.

If genuine in their attempts to resolve franchisee disputes, why RFG would not want us present at these meetings when specifically requested by franchisees, or to have an open line of communication with us, remains a mystery.

Meanwhile, a number of RFG franchisees have informed us of their depression, mental illnesses, distress, and suicidal thoughts that they feel has been brought on by operating their RFG outlet. One franchisee in particular informed us that they told the company on at least 3 occasions that they were suicidal, but RFG did not provide them with or refer them to any counselling services.

Another suicidal franchisee called us at midnight, completely distraught, desperate for help. We were told that in this instance, RFG responded to the franchisee and saw them in person.

This should be of serious concern to RFG-- franchisees are no longer just losing money or time. They are developing serious mental health issues as well.

For any true potential of RFG's future, there needs to be:

- accountability and responsibility taken for the poor form of the network (even if this must occur through legal and/or government channels),
- sweeping change in RFG management at all levels, including the Board of Directors,
- increase in the profit share arrangements for franchisees, and
- increase in franchisee support measures and systems.

We would also like to inform the committee that we have access to RFG disclosure documents (including draft franchise agreements) spanning years and brands, should they require a copy.

## Considerations

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- Franchisors that are doing the right thing have long been disaffected by the conduct of other franchisors. Given there are a number of food/hospitality franchise systems that appear to be growing at a phenomenal rate by using a model of underpayment and questionable practices, franchisors that are genuinely trying to do the right thing are unable to grow as fast as those cheating the system.

Fair competition is a must -- ethical franchise systems will be unable to grow and succeed while unethical franchise systems cheat their way to the top.

- Franchisor lobbyists, including franchisors themselves, often refer to studies or tools that indicate small independent businesses have higher failure rates and leave the market faster than franchise businesses.

What these franchise lobbyists fail to include in their analysis is that franchisees are bound by franchise terms in their agreements, where they must remain operating until the end of their franchise term or sell their business. While an independent operator could effectively walk away, the franchise operator may have no choice but to continue operating or even renew their franchise agreement while incurring huge losses in their business.

An independent business has the risk of being pursued for payments on their lease, however, a franchisee also has the added risk of being sued by the franchisor. We especially saw this with Retail Food Group franchisees.

Further to this, this inquiry is not about how much worse things may be elsewhere in the business world. Trying to distract the inquiry away from the very real concerns and issues facing the franchising industry is detrimental and indicative of franchisors and lobbyists desperate to protect the status quo.

## Recommendations

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A number of our recommendations would require a proper framework and serious discussion as to how they could be implemented. We have outlined possible ways the franchise industry could be fairer for all.

### Leasing

- Make it a legal requirement for transparency around leasing arrangements where the franchisee sub-leases from the franchisor.

This transparency would include: the option for franchisees to partake in lease negotiations, the landlord copies franchisees into all communication regarding the lease, all information regarding the lease negotiations be made available to franchisees (regardless of whether they are present in meetings) - this could include rebates or kickbacks that the franchisor may receive, rent reductions or increases, proposed planning and development, etc.

Where a franchisor is delaying lease negotiations through poor planning, poor communication, or deliberate interference, the franchisee should have the right to attend lease negotiations without the franchisor's presence.

## **Financials**

- In the instance of a franchisor selling an existing store (including where the former franchisee failed to sell it), make it a legal requirement for franchisors to provide franchisees with an accurate and complete financial history of the store, going back 5 years or to the store's inception (whichever is shorter).

This must include time periods where the franchisor has operated the store, or if the store has been sitting vacant.

If franchisor systems do not allow for individual corporate store financials (which seems absurd), then franchisors must redevelop their systems so that they can provide accurate financial histories to prospective buyers.

## **Franchisee Workers**

- Make it a legal requirement for franchisees to inform their franchisor when they intend to sponsor the visa of a worker.

Make it a legal requirement for franchisor to maintain a detailed register of all the sponsored workers in their network.

This could provide an extra layer of protection for vulnerable workers who could be enticed to pay tens of thousands or hundreds of thousands of dollars for visa sponsorship. It could also help prevent exploitation and slave-like conditions, as the franchisor would be aware and have the ability to conduct checks on the safety and conditions of sponsored workers.

## **Disclosure Documents and Franchise Agreements**

- Make it a legal requirement for franchisors to provide up-to-date (as at last financial year) average outlet financial figures in the disclosure document.

Average outlet financial figures (including figures such as sales and cost of goods) are provided to prospective franchisees and indicate the success and viability of a network. Franchisors like RFG have provided out-of-date average outlet financial figures to prospective franchisees in the disclosure document.

The way these figures are averaged also needs to be considered. Franchisors should not be allowed to, for example, take the most successful week across their network, using just a fraction of their outlets from a year or two prior, and present this as being the average outlet financial figures. This is extremely misleading and could misrepresent the viability of the network.

- Remove the legalese from disclosure documents and franchise agreements, and reduce the size of disclosure documents, disabling the franchisor's ability to hide or bury important information, and encouraging the franchisee to actually read the document.
- Make it a legal requirement for franchisees to receive legal and financial advice on their disclosure document and franchise agreement, even if the franchisee is renewing a franchise agreement.

Where a franchisee has little relevant business and/or industry experience, make it a legal requirement for the franchisee to also receive business advice on their disclosure document and franchise agreement.

- Make it a legal requirement for franchisors to exclude media clauses in the franchise agreements.

In their submission to this inquiry, Battery World wrote, "... there is another regulator with a stronger voice and more power than ever before – the public. This manifests in the power of the press and news media (legitimate and otherwise)..." They went on to say that, "Even if a franchisor's misdeeds were somehow not netted by the extraordinary web of government regulatory instruments in play, there is absolutely nowhere for a franchisor to hide their deeds from the public in 2018. And indeed this trend is increasing not decreasing."

After researching a number of franchise systems and helping to expose misconduct, we find Battery World's comments to be largely out of touch. This Inquiry itself shows the level of fear franchisees have... even when protected by Parliamentary Privilege, they opt to make confidential submissions.



We have observed large levels of fear by franchisees in speaking out because of the media clauses in their franchise agreements. While the media does act as a watchdog over corporations, they are still inhibited by franchise agreements where franchisees are bound by media clauses. This greatly diminishes the power of the press and news media, as they have little ability to protect franchisees who break the media clause for the common good.

Being an advocate for the media's role in regulating franchisor conduct, Battery World would also no doubt not be opposed to removing their own media clause in their franchise agreement, enabling the press and news media to truly manifest the power of the public.

### **Being a Franchisor**

- Make it a legal requirement for franchisors (ie Managing Directors and Chief Executive Officers) to obtain a qualification in franchising.

To the best of our knowledge, as it stands, franchisors do not need any education or training to start a franchise operation. While they could be successful in operating an independent business, this does not necessarily mean they have the skills, knowledge or training to implement a fair and ethical franchise network.

If a prospective franchisor is ready to invest in franchising their business, they should be properly prepared and qualified to do so. This could involve the requirement to complete a six months full time or one year part time course that covers common issues franchisors face, laws and ethics, successful systems etc, and provides them with a qualification. We understand that there are currently certificates that franchisors can opt to obtain. We have not completed any research on the viability of these certificates, but if proven to be useful and relevant, these kinds of courses should be mandatory for all prospective franchisors.

Where a prospective franchisor is already a successful business person, in recognition of prior learning, this prospective franchisor could opt to take a written exam that covers the content of the course to ensure they are adequately informed and have the abilities to conduct an ethical and fair franchise system without needing extra qualifications.

- Make it a legal requirement for franchisors to maintain a register of each outlet. Store Number, Store Address, First Established, Amount Of Times Sold, Reason For Each Sale, Did they go bankrupt etc.

This would be a publicly accessible database of franchise systems that includes information pertaining to the history of each outlet in each brand.

- Make it a legal requirement for franchisors to have a franchise licence.

Similar to a driver's licence, where franchisors break the rules, they accrue demerit points and are heavily fined. This licence could also hold the requirement for the MD/CEO to hold a qualification in franchising.

When the franchisor uses up all of their demerit points, the company is barred from operating and the company is given a reasonable period to sell or wind down.

There could also be a protection that enables franchisees to be released from their contracts and de-brand.

- Regulate the word 'Franchise'.

To the best of our knowledge, the word 'franchise' is not regulated. This means that companies like Harvey Norman can call their business partners 'franchisees' even if they do not meet the requirements to be a franchise system. This is open to abuse by using the word to entice people to join the brand, giving them the impression that they are a franchisee, yet the company may not be bound by the franchising code.

We kindly ask the committee if we are able to table a more detailed list of recommendations if we are called to give evidence.

We welcome the opportunity to be called to give evidence before the committee as witnesses, and we are happy for this submission to be made public.

Disclosure: Exposing corporate misconduct comes with its challenges, with funding being one of the biggest, and ensuring there are no conflicts of interest. In the interest of full disclosure, the details of how we fund our operation are included below. Franchise Redress is a business name registered to our company Operation Redress Pty Ltd. We also look into systemic misconduct in the toll road industry, and as such have a business name Toll Redress. In the past we funded ourselves by mostly relying on donations. More recently, we have been funding ourselves by writing research reports using public, non-material information and making them available for purchase. On some occasions, we have assisted individual franchisees to address their concerns with their franchisor for a fee.