

**Parliamentary joint committee on corporations and financial services  
Inquiry into Franchising Code of Conduct**

**30 July 2008**

**Submission by M. Wilson,**

**Private submission**

The Franchising Code places a gloss on a normal commercial contract between, in most cases, small business people. It tries to bring fairness into a commercial contract and get low cost dispute resolution.

Most franchisors are small business people with turnovers as franchisors which are little more than that of their franchisees. These small franchisors do a lot for a very small percentage of turnover. The franchisee is also a small business person.

The increasing legal burden imposed on the franchisors is restricting the founding of new franchise systems and is acting as a barrier to entry. Franchising is increasingly not a matter of doing business but of managing the risk of legal action.

Because of the legal costs and distraction from the core function, even an unsuccessful legal action can destroy a small franchisor and, as a knock on effect, destroy the businesses of 'happy' franchisees.

Franchisees also are threatened by the possibility of ruinous legal action by franchisors.

The remedy is to know of disputes and resolve them promptly. I propose that the Code require that all disputes relating to events in a financial year must be advised to the other party (franchisee or franchisor) within 3 months of the end of the year in which they occurred and taken through the dispute resolution process and that otherwise they can not be brought up again. This time limit on claims protects the franchisee and the franchisor by bringing honesty and transparency into the relationship and not allowing disputes to drag on or fester in the minds of either party and prevents dredging of history to create a claim (usually through a lawyer) by the franchisee or by the franchisor.

By reducing the size of the claims to events in the previous 12 months it makes it more feasible to arrive at a mediated resolution and reduces the likelihood of parties needing lawyers. It is also much easier to produce documentation and to remember the events and to find witnesses. It is a win for all parties.

**The landlord issue: excessive market power**

A large proportion of the disputes with franchisees in retail franchises have their origin in the landlord either increasing the rent or terminating a lease. This destroys the goodwill of the franchisee and leads to claims about other matters which would not have become an issue otherwise. On losing a tenancy the franchisee (and other

tenants too) lose the goodwill of their business, the value of the shop fit out, the cost of 'making good', redundancy pay to staff and they have no business to live off afterwards.

Action is needed on the lack of tenancy rights at the end of a lease and about the fiction of 'marking rent to market' in a shopping centre. How can you seriously pretend to have a market when there is a single monopoly supplier who has the unique right to build a shopping centre in the area, and is the only one with knowledge as to actual rents paid?

The solution is to, firstly, require a landlord to act in good faith by stating clearly what the rent for each tenant is in all the shopping centre, what their outgoing are, the space they occupy and the other inducements or benefits offered.

A second useful step would be to have the existing tenant have the first and last right to accept a tenancy offer and combine this with a prohibition on leasing premises vacated at a lower rent than the lowest rent offered to the existing but outgoing tenant. Currently shopping centre landlords say to tenants that they have others interested in the lease willing to pay a higher rent (raising suspicions in the mind of the tenant as to the accuracy of the statement). To achieve transparency these names and the rent offered should be published – the landlord is a monopoly owner and the issue is how to manage the landlord's much greater market power.

As often as not, if the tenant leaves, the landlord leases to another party at a much lower rent, a rent which the leaving tenant may have accepted but was never offered. The existing tenant should have the opportunity to save the goodwill of the store, the fit out, the redundancy payments and loss of income.

The landlord should also be obliged to offer a new lease within a reasonable period rather than leave a tenant at the will of the landlord.

Thirdly, the annual ratchetting up of the rent by a landlord is almost always above the inflation rate. This ratchet should be limited to the percentage increase in the Consumer Price Index. These increases on longer leases can lead to very high and totally uneconomic rents because they result in rents that outstrip the increase in the cost of living and hence in the prices that the retailer can charge its customers. But refuse to accept the increase and you lose your goodwill.

Fourthly, a landlord should be entitled to a maximum compensation on a tenant abandoning a lease of 6 months rent. If the landlord can not rent the premises out at the same rent within 6 months then it is likely that the rent was unfair in the first place because it was excessive.