

16
Joint Standing Committee on Corporations and Financial Services

Inquiry into Franchising Code of Conduct

Submission from

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1. Summary

This submission delivers evidence on the performance of the existing framework while offering an insight into one family's franchising experience and the systematic ruin of the ██████ network of franchisees.

Included is an overview of my experience with a number of stakeholders who have shaped the current franchising environment as one of uncertainty.

I have been associated with failed franchisees from a number of franchise networks with some on the verge of suicide, some suffering stress associated heart trauma, miscarriage, severe disorders ending in surgery, divorce and wave after wave of franchisees suffering serious and chronic depression.

Many providers to those franchisees were never paid and while many franchisees remain in debt, Government agencies have been called upon to support the financial and health aftermath of their franchising experience.

Evidence to this inquiry will repeat many of the issues previously referred to in a long list of inquiries that are yet to yield effective legislation for franchisees.

The consequences of abuse of franchisor power were first referred to by the Swanson Committee (1976) and then the Blunt Committee (1979). Such consequences were central to the Beddall Inquiry (1990), the Franchising Task Force (1991), Gardini's Review of the Franchising Code of Practice (1994) and then the Reid Committee (1997). In 1986 the Government produced 2 drafts for a Franchise Amendments Bill but in 1987 decided not to proceed following criticism from franchisor lobbyists.

This year again we have seen the West Australian and South Australian government's inquiries recommend broad reform to counter the continuation of such abuses and consequences.

Robert Gandini in Report to Senator the Hon Chris Schacht (1994) found the following areas of dispute between franchisees and franchisors;

- *Charging excessive prices for goods supplied to franchisees;*
- *Secret rebates and commissions from suppliers;*
- *Discrimination in terms of trading between company owned outlets and franchised outlets;*
- *Encroachment on the franchisee's geographic trading area;*
- *Failure to address lack of viability of franchise outlets;*
- *Making substantial increases to renewal fees;*
- *Failing to provide adequate service and support to franchisees;*
- *Unwillingness to discuss and negotiate problems;*
- *Using advertising levies for other purposes;*
- *Intimidation and victimisation of franchisees; and*
- *Unfair terminations.*

Then in 1997;

"2. The Reid Committee report reveals that the current void in Australian franchising law concerning franchise renewals is a consequence of over 30 years of policy failure by successive Australian governments, with the exception of legislative intervention in relation to petrol station franchises, and the enactment of the highly uncertain unconscionability provisions in s.51AC of the Trade Practices Act.

3. At paragraph 6.26 the Reid Committee asked the pertinent question: "why, if the economic and moral case for effective legislative action is so persuasive, Governments have been so reluctant to act". The only answers provided were that it was perceived to be too onerous for franchisors, was an unwarranted interference with the parties' freedom to contract, and introduced uncertainty and an unnecessary regulatory burden. The Reid Committee analysed and rejected those

arguments in making a recommendation for its proposed "unfair conduct" law."

CFAL Supplementary Submission – Reid Committee 1997

I provide detail on how abuse occurs and ask the committee to give consideration to other industry frameworks.

The 1997 Reid Committee inquiry came about by preceding years of inefficiency where failed legislation allowed for the financial ruination of families, the consequential damage to the franchising industry's reputation and the potential of future cost to Australia;

*"The Committee found that these problems have considerable economic and social costs in that they contribute significantly to business failure. The social costs identified by the Committee included stress, marriage breakdown, poor health and suicide. The economic costs of the business conduct issues raised with the Committee include an inability by small firms to gain a return on sunk costs and market inefficiencies arising out of exploitative conduct. The overall costs of small business failure in terms of its implications for employment and growth also are relevant."**

*House of Representatives - The Trade Practices Amendment (Fair Trading) Bill 1997

I ask the Committee to consider the power of rogue franchisors to operate while often leaving minimal evidence of ruthless, unconscionable and/or criminal behaviour; except for the numbers of victims. I provide undeniable numbers.

I reason that attempts to find an acceptable balance between the various lobby groups must be avoided so as to produce legislation and a regulatory framework that best meets the identified needs within franchising, no matter what effort is required.

I describe my concerns for the protection of all investments in franchising to better sustain and grow this industry's contribution to the Australian economy.

I offer evidence that while the existing framework provides protection of the franchisor investment there is very little protection for franchisees and providers to this industry. I argue that the cost is not in the regulation of franchising; the greater cost is in not effectively regulating franchising.

I caution of the new and future danger to the reputation of franchising and its contribution to Australia's economy where organised victims have previously targeted specific rogue franchisors and ineffectual authorities. Any move to attack franchising as a high risk, unprotected industry through continued and effective utilisation of Internet and media would increase uncertainty and suspicion for this industry.

There has been growing media interest in the horror stories of victims of rogue franchising. I maintain that restoring public confidence will not be achieved without a public acceptance that government is determined to effectively deal with unconscionable abuses of power within franchising.

References to Australia's current franchising regulatory framework as being world's best practice are deliberately misleading. Those of us that have researched regulatory frameworks throughout the western world conclude that this term is not applicable anywhere. Franchising law internationally is a work-in-progress at best, or an after-thought of legislators swayed by lobbyists.

I ask this inquiry to produce protection against worst-case franchising. This includes examples of the get-rich-quick franchisors that design systems to "churn" franchisees knowing that such systems must have a short life span but where there is no penalty throughout, or when they collapse.

Recommendations within this submission are based on 20 years of experience, extensive research and involvement with franchisees from many franchise systems over more than 6 years.

I support and make recommendations for prospective franchisees to be required and given the ability to determine whether a transparent franchise model is likely to be successful.

Consider these figures; up to 75% of franchisors in the US and Britain fail in the first 10 years of operation** and they destroy countless numbers of franchisees in the process. In Australia initial research suggests over 30% fail*. These typically take with them the life's savings of Australian franchisees as reported in the recent [REDACTED] franchise disaster.

* Franchising and Own Your Own Business Magazine, vol. 9, no. 5, Advertiser Index p.136, HH&M Media, Sydney.

** Shane, Scott A 2005, From Ice Cream to the Internet: Using Franchising to Drive the Growth and Profits of Your Company, Prentice Hall, Upper Saddle River, NJ.

** Stanworth, J, Purdy, D, English, W & Willems, J 2001, 'Unravelling the Evidence on Franchise System Survivability', Enterprise and Innovation Management Studies, Vol. 2, No. 1, pp.49-64.

** Blair, D. Roger & Lafontaine, Francine 2005, The Economics of Franchising, Cambridge University Press, New York.

It isn't just the numbers of franchisors that fail that should be of interest and we need to understand why they fail and educate through honest reporting.

"Getting corporate law right is vitally important to Australia and Australians for some very simple reasons - because creating a better environment for business and investors will lead to job creation and sustainable economic growth."

* Senator Chapman – Association of Financial Advisors - 11 December 2001

I am greatly concerned as to the short time frame for submissions to this inquiry. The organised and funded submissions opposing real reform will most likely and greatly outweigh those from the coalface of franchising. It should

also be noted that many franchisees fear reprisals from their existing franchisors or are signatories to confidentiality [gag] agreements.

I expect that all franchisors will be aware of this inquiry and much less than 1% of Australian franchisees will hear of it until 2009. The committee's perception of the extent of the problems will be underrated where only a fraction of problem franchise networks will know to make submissions. Appendix C lists networks reporting disputes following minimal research.

This inquiry was instigated 25 June 2008. On 21 July at a meeting with FAAi, it was requested that inquiry information be published by the regulator of franchising at its website. ACCC agreed but at the time of completing this submission the regulator of franchising has withheld the publishing of the existence of this inquiry.

2. My franchising background

My involvement in Franchising began in 1988 when I was employed by a quality franchisor, [REDACTED]. I then owned a successful [REDACTED] franchise with my wife (1997-2000). I became a franchisee victim of a rogue franchisor (2000-2004) along with almost a hundred other franchisees when the [REDACTED] franchise system was sold in 2000. My franchise agreement was terminated in 2004 and I was bankrupted by my franchisor in 2005.

I became a dedicated franchising researcher (2002) and became a volunteer consultant to the Australian Franchisees Association and its members (2004) and later continued to support the new Franchisees Association of Australia Incorporated and member/non-member victims of franchising fraud from various networks (2006). I now operate with a working group of franchisees dedicated to the pursuit of effective franchising protection and I provide consultancy to National Franchisee Advisory Services (NFAS).

I began employment with Australia's largest and most successful automotive franchisor in 2006 in franchise support, business development, training, IT, complaints and compliance roles.

I have 20 years experience in franchising in various management, marketing, training, operations and compliance capacities and as a franchisee for 7 years. While this submission focuses on the opportunistic franchising I am passionate about the potential of franchising when it operates well.

3. [REDACTED] Pty Ltd

(i) [REDACTED] franchising

When [REDACTED] originally purchased the [REDACTED] master franchise from [REDACTED] [REDACTED] in 2000 he advised the network that there was to be a re-image program for Australian [REDACTED] shops and

until that was complete there would be no advertising performed nationally so that the monies could launch the new direction and image of [REDACTED].

Almost all of the advertising fund contribution from franchisees, worth on average \$3M per year, then disappeared from 2001 to 2007.

During this period franchisees incurred exorbitant mandatory operating costs introduced or caused by the franchisor. Re-image, repair parts, equipment and service provider prices became uncompetitive as rebates became abusive. [REDACTED] introduced mandatory inflated software and computer hardware costs and took control of head leases where rents and administrative charges were grossly excessive. [REDACTED] was outrageously profiteering from every aspect of the franchisees' businesses.

This and the failure to advertise began to cause franchisees to fail. [REDACTED] were forced to take back [REDACTED] franchisee shops and in that process then sold them to new franchisees. [REDACTED] found that this was very profitable and set about introducing more and more income streams via introductions and alterations to the Franchise Operations/Standards Manual.

Compliance to the Operations Manual was a contractual obligation of franchisees and seen as not only a useful method to alter a contract without the agreement of franchisees; but it would then assist a rapid escalation of franchisee failure and [REDACTED] consequential opportunities to profit from the re-selling of franchises.

Support and training from [REDACTED] was virtually stopped as early as 2001 and where experienced personnel were dismissed or resigned.

Franchisees were forced to add expense to their bottom line through providing for their own local advertising, training and support. And many had to add the cost of a lawyer. This, combined with every other [REDACTED] "initiative", grew [REDACTED] ability to remove franchisees thereby gaining shops for a pittance or nothing.

Franchisees who had become very vocal in their complaints from 2002 to 2007 were then targeted with threats to terminate their agreement. This would mean that they would almost certainly lose their homes so most capitulated. Almost all were to fail anyway.

Mediation was openly used to force a franchisee into additional cost where the franchisor would not entertain any issue in dispute after proclaiming beforehand that any agreement reached in the presence of a mediator would be discarded after mediation.

Those that didn't capitulate received a continual flow of threatening letters from [REDACTED] lawyers and unreasonable and expensive demands from state managers. Then most of those failed as well. Very few were able to find buyers and a number refused to even attempt to sell to an innocent third party.

(ii) [REDACTED] franchise turnover

The following figures do not cover the period from November 2007 to present, as [REDACTED] has not needed to provide the necessary information within Disclosure. [REDACTED] cannot sell franchises.

[REDACTED] unwittingly provided the numbers of franchisees turned over from comparisons of national franchisee contact sheets that were produced, on average, every 6 months.

From 2001 to October 2007;

2	[REDACTED] shops changed hands 5 times	(10)
8	[REDACTED] shops changed hands 4 times	(32)
21	[REDACTED] shops changed hands 3 times	(63)
43	[REDACTED] shops changed hands twice	(86)

When [REDACTED] purchased [REDACTED] in 2000 there were 109 [REDACTED] shops.

By early 2004 [REDACTED] had grown the network to 129 shops but this was largely due to an acquisition of [REDACTED] workshops as company shops typically within a few hundred meters of existing franchised businesses.

By November 2007 there were only 86 [REDACTED] shops left with 27 of those being company shops.

Today I am advised that there are less than 50 franchisees left in the [REDACTED] system and the majority of them struggle. [REDACTED] now operates approximately 40 company shops due to lease obligations they cannot avoid. Franchised shop numbers continue to decline.

I believe this to be Australia's worst case, to date, of franchise churning.

Appendix A [page 39] lists the names of 169 known [REDACTED] franchisees that were mostly churned over an 84 month period. There were more.

Almost every franchisee turnover involved severe financial damage to, or the financial ruination of, a family.

(iii) ██████ – who it cost

It is estimated now in 2008 that almost 190 franchisees were churned over a 7-year period.

Many franchisees that failed left substantial debt with suppliers, landlords, banks and the ATO. Often franchisee staff could not be paid their full entitlements.

Many failed franchisees are still in debt to the Australian Tax Office, their companies are gone, the businesses are gone, their homes are gone and their savings are gone. Innocent franchisees now have their ██████ aftermath controlled by their bankruptcy trustee. Marriages have failed and health has been destroyed. Government support agencies often bear the cost. One franchisee committed suicide.

All this occurred while constant complaints were made to ACCC, and then ASIC, the ATO, media and anyone else that might help.

██████ franchise failures avoided accurate inclusion in disclosure documents because they were registered as a sale of a franchise where franchises were acquired by the franchisor against a debt to ██████ as the exiting franchisees attempted to escape without losing their homes.

Incoming franchisees were not aware until it was too late and when they did become aware they were consistently given the catch-cry of the rogue franchisor and the FCA; the previous operator "*had not followed the system*" and/or "*was a poor operator*".

The Franchise Council of Australia and the ACCC have relied on a relatively small number of the ██████ franchisees coming forward to complain to authorities. The reality is that most either;

- a. had totally lost faith in the ACCC based on historical, well-known and ineffectual outcomes in relation to ██████ complaints that had been submitted and/or,
- b. had been driven into depression and other often severe health problems and just could not cope with a demanding and under-performing ACCC and/or,
- c. had made a commitment to family to move on and not fight a fight that they were being told they could not win or,
- d. had become a divorce statistic and totally lost interest in anything and/or,
- e. had become bankrupt and accepted they could not fund justice.

My wife and I are in our mid-fifties. In only a matter of a few short years under the new franchisor we lost our home, our previously successful business, our savings, our stock portfolio and our cars. We were both targeted and my wife was subjected to individual intimidation in an attempt to remove my complaints made on behalf of a large majority of [REDACTED] franchisees.

These consequences are by no means uncommon in [REDACTED] franchising or in a number of other franchise systems.

I attempted to self-defend against [REDACTED] legal action against my wife and I for more than a year. In the Federal Court documents filed by [REDACTED] Lawyers on [REDACTED] behalf showed that [REDACTED] had invested in private detectives for 2 years from Townsville in Queensland to Bangalow in NSW and then to Redcliffe in Queensland.

In the final hearing [REDACTED] was represented by a Queens Council, a barrister and a law clerk. I was penniless and surviving on a meagre government benefit. [REDACTED] outlaid whatever was necessary to silence me and intimidate what was left of the franchisee network. [REDACTED] were successful in attaining an infinite Federal Court "gag" order* to prevent me from warning others.

* Federal Court of Australia - [REDACTED] Australia Pty Ltd v [REDACTED] Pty Ltd FCA [REDACTED]

My wife and I are now bankrupt. My wife and I were treated for depression at times through this period. We will not at all recover financially before we are unable to maintain employment and there is a financial flow on cost to our children and grandchildren.

Our life's efforts were stolen and destroyed and the man responsible for so many similar franchisee outcomes will retire in luxury and will not have seen the inside of a court. He is, and has been protected by immorality, incompetence, wealth and the need to conceal such immorality and incompetence.

4. Psychological strategies

Most people with no real franchising dispute involvement often question the legitimacy of complaints where there is a relatively low level of recorded official complaints.

In my dealings with a number of franchise networks in serious and legitimate dispute I have encountered a common thread as to psychological tactics employed by franchisors to remove complaints and/or complaining franchisees.

In most of these networks there are those that lead and those that passively support the complaints. Leaders tend to be the targets of a constant barrage of warnings, demands, standards inspections, financial audits, threatening or

intimidating telephone calls and threatening or intimidating visits to the franchise business.

What is an acceptable business operation, and often highly commended, where the franchisee is not publicly supporting complaints, is then found to be unacceptable to the franchisor where the target franchisee supports complaints. The franchisor will then invoke, or threaten to invoke, his contractual rights over the franchisee while applying the previously mentioned tactics. The franchising opportunist knows that;

- i. The franchisee can not compete financially with threatened litigation,
- ii. The franchisee knows his entire life's efforts and financial worth are on the line,
- iii. The message will reach the entire franchisee network,
- iv. The ongoing strategic attack will either;
 - a. Cause the franchisee to fall into line, or
 - b. Cause further financial pressure as the business performance suffers through designed distraction, and
 - c. Cause relationship friction as the constant attack succeeds

These tactics become well known within the franchisee networks ensuring most passive supporters, and some leaders, will quietly remove themselves from the dispute process.

Franchising opportunists know that franchisees typically have guaranteed finance where if they lose the business, they then lose their home and are left with large debt. Franchisees predictably know they will not recover financially and that their family, their children and grand-children, will suffer. This is the franchisee's fear and the rogue's strength.

This allows the deliberate psychological campaign to wear down the franchisee and impact on every aspect of not only his or her life including family and employees. Most complaining franchisees then submit. Their state of mind worsens when they find that their eventual demise may have been guaranteed as the subject(s) of complaint(s), typically based in escalating financial loss, were not resolved.

An additional and avoided aspect to this psychological attack is the role played by the ACCC where many franchisees complain that the ACCC mislead them to believe that justice is achievable where historically it was not to be.

Whilst attempting to fend off the psychological barrage from the franchisor and suffering the designed effects of that barrage, their world collapses when they eventually receive a letter from the ACCC stating that the franchisor had been contacted and had denied the legitimacy of the complaints and so the ACCC would not be proceeding. Few are then in a position to proceed with any civil option. Few have the will to continue.

It is common knowledge that franchisees from many networks often are in need of professional help and medication and at any stage through this intentional process.

5. ACCC investigations

If one were to form one's opinion on the health of franchising from the great majority of references from the ACCC one would conclude that the few victims that exist do so because they were poor operators who didn't fit the franchisee profile. If one forms one's opinion from all available sources one would have to conclude that either the ACCC are incompetent or have deliberately misled the Australian people and government.

The following are summary examples of ACCC investigations;

- (i) In ██████████ Australia Pty Ltd v ██████████ Pty Ltd [WASC ██████████] December 2002 in the Supreme Court of Western Australia, David ██████████ took action against his franchisor for wrongful termination of the franchise agreement, unconscionable conduct and wilful damage where the court found in favour of ██████████.

██████████ had previously complained unsuccessfully to the ACCC and was forced then to undertake expensive civil action. Through Freedom of Information it was found that an ACCC lawyer had recommended that the complaint be pursued by the ACCC. Following the decision of the court the ACCC took no action against the franchisor.

- (ii) In the ██████████ complaint the evidence from 20 franchisees was detailed and legitimate. Graeme Samuel reported the ACCC found nothing amiss but he refused an ACCC Freedom of Information application for the records of the investigation stating it would take 7,600 hours to compile their records at a cost to the franchisees of potentially more than \$150,000.

The ACCC are suggesting it takes more than 5 times longer to compile their files than it took to investigate the complaint.

"The ACCC in the end endorsed some ██████████ practices, stating in its media release that the evidence supports the view

that [REDACTED] is generally reluctant to initiate termination and does not have a record of repeatedly selling franchise sites."

Murray Deakin and Chris Nikou – Middletons Lawyers – www.mondaq.com – 19 May 2008

It should be impossible to ignore the churning of [REDACTED] franchisees and their complaints but the ACCC are aware that [REDACTED] is represented by [REDACTED].

- (iii) [REDACTED] franchisees en masse have repeatedly complained to the ACCC in every state. One central issue was the forced compliance to retail pricing that grew gross revenue to maximise royalty while franchisee profitability was destroyed. Another was the use of threats and intimidation to remove complaints and/or franchisees where churning and confidentiality clauses were proving to be tardy or ineffective.

In Western Australia the complaints were overwhelming where corporate threats denigrated into often brutal, thuggish screaming episodes within shopping centre malls. The ACCC found nothing amiss with the behaviours of the master franchisees. Then the main source of complaint, one of the master franchisees, was charged in December 2007 with the murder of his franchising partner and awaits trial.

The [REDACTED] franchise abuse must be recorded as the most unsophisticated franchising disaster this country has witnessed.

[REDACTED] should be called upon to answer questions in relation to the behaviours of [REDACTED] whilst in his former role with Australian Franchisees Association.

- (iv) The ACCC investigated numerous complaints from [REDACTED] franchisees relating to misappropriation of advertising funds, various clear breaches of the Code, third line forcing and numerous other issues that would come under unconscionable conduct.

While franchisees were being turned over at a phenomenal rate the ACCC could not find [REDACTED] had breached any part of either the Code or the TPA.

One of the worst examples of ACCC negligence was a complaint lodged regarding a Victorian franchisee, [REDACTED]

This was a matter where a young Indonesian/Australian [REDACTED] franchisee had been sold a franchise. He had no mechanical

background and no history of successfully operating a business at any level. He did not have the necessary communication skills to be effective but he could borrow the purchase price.

████████ confronted him after 12 weeks in the business over allegations that he had failed to pay royalty on an invoice not processed through the ██████████ computer system. He was initially ordered to pay a fine to ██████████ of \$20,000 that was later reduced to \$10,000. If he didn't pay he was told he would be thrown out of his franchise and his home and then ██████████ would have him deported.

Witnesses, including the then state manager for ██████████ who resigned immediately over the incident, supported the complaint. The paper trail substantiates the payments. Expert witnesses negated any possible attempt at any defence by ██████████ and unreservedly stated that the franchisee would not have known how to defraud anyone.

The complaint was lodged with Victorian police and the investigating officer stated, after interviewing everyone involved and collecting all the necessary evidence stated that they would successfully prosecute. This was the identical information and witnesses that had been handed to the ACCC.

In October 2007 police finally interviewed the owner, ██████████ ██████████, and the National Operations Manager of ██████████ ██████████ ██████████. In June 2008 the Operations Manager was charged and awaits his criminal committal hearing in February 2009*.

*Melbourne Magistrates Court – Criminal - Case ██████████

The ACCC could not find unconscionable conduct or any breach of the Code and did not refer this matter to another authority.

After securing the money from ██████████, the ██████████ returned immediately to ██████████ declaring they had "got the little geek". ██████████ was unquestionably the recipient of ██████████ "fine" but he has not been charged.

It is worth noting that ██████████, with an industry reputation based on his ability to abuse a more powerful position and in the process play an essential role in the demise of the ██████████ franchise, left ██████████ to be employed as the national network development manager for ██████████ where one tactic was to give a tyre dealer a choice to sign a franchise agreement or accept the loss of the dealership.

██████████ should be required to answer questions as to who directed him to extort an illegal fine from ██████████ and his knowledge of the ██████████ franchising strategy.

- (v) ██████████ franchisees from across Australia complained to the ACCC where I delivered a 300-page complaint in 2003 to their Townsville office. It primarily referred to the theft of the advertising fund and that ██████████ were threatening and intimidating franchisees. It was never read and I collected the untouched complaint from that office after 3 months after being advised originally it would be sent to Canberra for evaluation.

Following media interest the ACCC eventually did force ██████████ to undertake an audit in 2004. ██████████ produced a 2-page audit report that stated that the auditor had only tested samples of invoices to verify the processing system for invoices. The fund balance was provided by ██████████.

The entire automotive industry knew that ██████████ was not advertising and the ACCC could have easily gained that information from the advertising industry's reporting and had the power to perform an investigation of ██████████ advertising fund accounting. Millions of dollars vanished annually and the ACCC did nothing.

The ACCC mostly relied on a denial by the franchisor to all complaints, including these, and in relation to threats and intimidation the ACCC stated that although franchisees were making identical statements in every state; they could only review complaints individually which meant it was one party's word against another party's version and they would not act.

Franchisees argued that if forty women from across Australia complained that Mr Samuel had molested them he would be in jail.

The ACCC never contacted any franchisee to ask for any additional information on any occasion before the complaints were rejected.

██████████ should be required to answer questions regarding the turnover of ██████████ franchisees and the disappearance of advertising funds.

- (vi) In **Ketchell v Master of Education Services** we once again saw a franchisee complain to the ACCC only to be forced to take civil action and win. There was no effective ACCC investigation or willingness to protect the franchisee, or give credibility to the Code.

While this matter is under appeal, funded by the FCA, it points to differing legal opinion regarding ambiguity in the interpretation and intent of franchising law that causes uncertainty.

- (vii) Recently there was another complaint similar to the Ketchell case that also involves the [REDACTED].

Here we see a franchisor, [REDACTED] that did not bother to create a disclosure document and therefore one wasn't provided or signed as required by the Code. Where required solvency statements and a failure to provide financial reporting are in breach of the Code. Where the franchisor did not require franchisees to provide statements that they had received, read and had a reasonable opportunity to understand the disclosed document and the code.

Where the franchisor had not received signed statements from franchisees of receiving independent legal advice, independent business advice or independent accountant advice, nor received a signed statement from the franchisee that the franchisee had been told that such advice be sought and decided not to seek it.

Where the franchisor attempted to interfere in the rightful formation of a franchisee representative body and ignored attempts at mediation.

These are all breaches of the Code and all of these franchisees are contractual prisoners to a franchise model that isn't viable. The ACCC response to franchisees rejected the format of the complaint.

The CEO of [REDACTED], [REDACTED], is a director of the [REDACTED] and is registered with the Government as a [REDACTED] for the "[REDACTED]" .

- (viii) Recently the ACCC has undertaken to pursue unconscionable conduct in relation to [REDACTED] franchise.

I would suggest that this is not consistent behaviour from the ACCC and not coincidentally follows submissions to and the recommendations of both the West and South Australian inquiries into franchising; and the announcement of this Federal Inquiry into franchising which will once again refer to the performance of the ACCC.

Such newfound ACCC determination has been a recycled annual event with a typical life span of a few weeks and usually following critical media interest that could not be ignored.

“Those who blatantly deceive potential small business owners with offers of bogus or unworkable small business opportunities are being effectively criminals and can expect no leniency from the Commission.

*We are already examining a number of different scenarios which we believe are criminal and are taking steps to not only shut down the perpetrators but to impose criminal sanctions.”**

*Graeme Samuel hypocrisy – Speech to Australia–Israel Chamber of Commerce - **24 February 2005**

Frustrated franchisees, for the most part, have lost faith in ACCC investigations and their unwillingness to pursue the most blatant breaches of the TPA and the Code.

The bizarre ACCC response to the application for Freedom of Information from [REDACTED] franchisees offers grounds to question all ACCC investigations. If the ACCC were forced to disclose the records of that investigation it would offer the most compelling example of ACCC ineptitude.

The ACCC has hidden and understated the level of franchising disasters. Its investigations have clearly been a charade and its media campaign to defend the lack of funding and lack of effective law has been misleading and in so doing; it has assisted the efficiency of franchising opportunism.

Graeme Samuel, John Martin and/or Nigel Ridgway should be required to answer questions as to the influences that have retarded the performance of the ACCC and its investigations.

6. Franchise council of Australia

While the preferred position is to not offer my informed opinion on the influence FCA has in Australian franchising, it is time to publicly acknowledge the role of the Franchise Council of Australia in shaping the present franchising environment.

FCA represents franchisors. FCA does not represent franchisees or franchising. Anecdotal evidence from many franchisees from many networks and my personal experience confirms that FCA does not entertain complaints from franchisees. FCA plays a vital role in securing business for law firms, brokers, lenders and other providers to franchisors.

“The other parties who propose that there is not a problem, that nothing needs to be done, the present measures work, are the very same parties who so rigorously and comprehensively opposed Minister Beddall's amendments back in 1992. The same arguments were trotted

*out, the same thing. Their purpose in all truth is to deflect and defer and hope another 24 years will go past before anything has to happen.”**

*Michael Delaney, MTAA, *Transcript of Evidence*, p. 335. Reid Committee 1997

“The Franchise Council of Australia purports to act for franchising eg franchisors and franchisees. This is akin to corporations representing unions.”

Howard Bellin, IF International – The Australian Financial Review, 7 July 2008 page 59

The FCA constantly advertises that it is the peak body for franchising representing both franchisors and franchisees. While FCA has cultivated a close relationship with the ACCC this is clearly misleading and deceptive conduct worthy of ACCC intervention.

FCA has developed an appearance that it has created a submissive and intimidated ACCC to better promote its value to franchisors.

Whilst FCA is a not-for-profit organisation you do not have to scrape away very much before you find very lucrative relationships that prosper from the lobbying of FCA to resist change to law and regulation where existing law and regulation have allowed for very profitable conflict.

[REDACTED]

FCA has performed a great disservice to the reputation of legitimate franchisors and while most creditable franchisors have little or nothing to do with FCA, the naïve do not appreciate the underlying business strategy.

Importantly I ask the Committee to bear in mind that the Franchise Council of Australia, and their predecessor FAA, has repeatedly advised governments that there are no endemic problems in franchising. A string of inquiries suggests otherwise. I would ask the Committee to consider the current wave of personal horror stories and submissions to previous inquiries that, like most inquiry participation, represent only the tiniest tip of the iceberg.

Earlier this year the Chairman of the ACCC, Graeme Samuel, admitted that franchisee churning existed in Australia*. On the same day the FCA’s Richard Evans continued to deny it was possible *“because it was against the law”**.

*2UE Radio – Glenn Wheeler Weekend Show - Franchising – 9 February 2008.

FCA member standards do not include any declaration that a serious breach of the Code or law will be referred to the ACCC or an appropriate authority. A member may lose membership but FCA report no such instance.

FCA has maintained that it welcomes industry review while constantly opposing any change at all to existing laws stating there is currently no disadvantage to franchisees. Both state inquiries and expert academic opinion indicate otherwise. FCA does however; fund research and influence self-interested opinion to support their needs and the committee will receive same.

The following rebuttals are to key FCA arguments in its submission;

The Franchising Code of Conduct requires a comprehensive disclosure document prior to a franchisee signing a franchise agreement and the format is simple, detailed and working well within healthy regulation and the potential to be breached should a franchisor stray.

State Inquiries, anecdotal evidence from franchisee victims and submissions to this inquiry offer absolute reason to conclude that disclosure requirements fail miserably.

The recent changes to disclosure requirements will definitely assist in the due diligence process however and as will be outlined there is critical information not supplied regarding franchisor experience, rebates, lease arrangements etc.

Further, since there is effectively no penalty for breach of these requirements and since the ACCC will not pursue it, the only time it would be of relevance is in the unlikely event that a franchisee could fund a private legal action.

The Code requires franchisees to obtain legal, business and accounting advice, or certify they have been told they should do so but have elected not to obtain advice.

Franchisees who elect not to gain advice or who often gain such advice from professionals without franchising experience are in the majority.

Prospective franchisees deal with experienced franchise salespeople and they make foolish and emotional decisions. Many succeed because of the quality of the franchise model; when they fail they damage the reputation and future potential of franchising when they often lose everything.

Various Code requirements govern the operation of marketing funds, prescribing a process for transfer and limiting the grounds for termination**.*

*Marketing funds are reported internationally as an enormous temptation for rogue franchisors. ██████ offers an insight into how misappropriation can occur and be outside of the reach of the regulator.

These are often multi-million dollar funds controlled by an audit requirement that does not authenticate charges to advertising funds. The audit merely verifies the invoice process, the cost of various categories and the balance for the fund.

Where the franchisor or a third party associate company to the franchisor can provide exorbitant invoiced charges to the fund and where franchisees can be refused access to detail must be eliminated.

With reference to ██████, the ACCC did suggest to ██████ that "had the Code meant a summary audit they would have said a summary audit", but they then did nothing about it.

**Opportunist franchisors utilise an ability to refuse the sale of a franchise on concocted grounds and neither the Code nor the ACCC have dealt with those occurrences. Refusal has proven to be a useful tool when the franchisor's intent is to win the franchise back for a pittance by ensuring the franchisee will fail while unable to sell.

The rogue's preferred outcome in this instance is the financial collapse of franchisees while avoiding Code grounds for termination to conceal this practice.

The mediation based dispute resolution procedure set out in the Code has been extremely successful, with over 80% of disputes being successfully resolved while the cost of mediation is minimal.

Mediation continues to allow a rogue franchisor the ability to use the process to further drain the finances of a franchisee and where the opportunist franchisor can flaunt that there is no requirement to abide by any agreements made in mediation.

Mediation is only successful where franchisees and legitimate franchisors participate in good faith and where an 80% success rate represents very few that involve rogue franchising and those franchisees that don't bother.

The Trade Practices Act s52, and supplemented by 51A prohibits misleading or deceptive conduct and ensures that a franchisor must be able to prove it had reasonable grounds for making any representation as to a future event.

Under the regulation of the poorly funded ACCC the financially weak victim of opportunism must contest such claims and provide evidence that typically isn't offered in hardcopy by the rogue franchisor.

Within the TPA, s51AC prohibits unconscionable conduct and suggest that a well-resourced regulator – the ACCC – has extensive powers of investigation and prosecution to oversee the industry.

Courts and the ACCC are on record as having great difficulty pursuing unconscionable conduct. State inquiries and anecdotal evidence suggests that the ACCC requires dedicated funding and greater power to effectively investigate and prosecute franchising complaints.

This is typically and deliberately misleading where every review of “unconscionable conduct” definition has confirmed the enormous difficulty associated with pursuing such action.

Any aggrieved franchisee can, at no cost, seek to have the ACCC investigate any matter where there has been an alleged breach of the Code or the Trade Practices Act. The ACCC is well resourced, is duty bound to investigate all claims where there is a breach of the Code or the TPA, and has a strong track record of taking enforcement action where necessary.

Submissions to both state inquiries and to this inquiry detail attempts to have the ACCC effectively deal with complaints. The ACCC’s hands are tied because of a lack of funding, a lack of effective law and I suspect a lack of interest. The ACCC record is clearly abysmal with very few franchising complaints resolved, franchisors rarely prosecuted and all within a regulated industry where casualties are enormous.

FCA continues to proclaim their lobbying efforts to franchisors while their efforts protect dispute based revenue for legal firms specializing in franchising and the brokers who sell the aftermath. Quite clearly and blatantly; FCA damages the franchising industry while misleading government.

“Because there are so few major market opportunities in Australia, the likelihood of brand failure there is greater than the American experience. Mistakes can’t be buried in the large numbers in Australia like they can be in America. When the IFA [International Franchise Association] is finished with the Australian government, it will have either no franchise regulation or it will have regulation so weak as to be a ridiculous charade.”

Richard Solomon – Franchising Attorney Houston, Texas – “Australian Franchise Law: Assurances of Protection or Just More Christians Thrown to the Lions?”- www.bluemaumau.com - 27 Jun 2008.

The FCA campaign boasts a large budget specifically targeted to repulse attempts at reform. It will be utilized for submissions to this committee and then for intensive lobbying to water down change once this committee delivers its findings and recommendations to parliament.

Professor [REDACTED] is an example of FCA's independent franchising opinion. He produces FCA sponsored research and is a former board member of FCA and provides Counsel to [REDACTED].

Franchise brokers often promote themselves as "consultants", "advisers" or "advisory centres" for franchisees. This is intentionally misleading where their income is typically generated from "commissions" from franchisors. These operators rely heavily on a supportive relationship with FCA as the main contact source for franchisor business. Their advice to franchisees and government is usually prejudiced and self serving.

It is not unreasonable to ask that elected lawmakers critically review those submissions and those that support FCA attempts to block reform to produce another ineffective compromise.

*"Their purpose in all truth is to deflect and defer and hope another 24 years will go past before anything has to happen."**

*Michael Delaney, MTAA, *Transcript of Evidence*, p. 335. Reid Committee 1997

The majority of franchisees in Australia are in healthy franchises and do not appreciate the need for a national representative body. Franchisees in dispute are usually in financial difficulty and unable to support such a representative association.

I would ask that Government consider funding an independent organization to ensure an effective level of franchisee representation.

7. The cost of regulation

The main concern that saw the 1997 inquiry fail to deliver responsible protection that lead to this inquiry 11 years later and again dealing with identical issues, was the argument against cost that was loudly put forward by lobbyists.

With the advent of dramatically increased Internet use, we now even more must consider the greater cost to franchising where at this time very few franchise systems are publicly accepted as quality operations.

Franchises such as Harvey Norman and McDonalds give credibility to an industry that is mostly viewed with suspicion. That suspicion will increase dramatically if continued and growing Internet and media exposure allows the focus to be on rogue operators.

To understand future costs to franchising and the economic effect there is a need to accept what franchisors will acknowledge. Critical to franchising is network numbers and growth. As infrastructure costs for support, training, product development, IT, and marketing needs increase there is an essential

need to grow a franchise network to support those costs to provide a legitimate return on investment.

While some franchisors will opt to a number of brands under one management structure to spread those costs, that is not always an available option.

When franchise numbers stagnate, the franchisor's infrastructure costs will overwhelm if not reduced. Cut backs in turn damage the attraction of a franchise and produces a self-destructive profit slide. This may be overcome with the infusion of new investor capital; however, in this age of Internet the battle to outlast a rogue reputation will be a long one.

We see this now with the [REDACTED], [REDACTED] and the [REDACTED] [REDACTED] networks where it is almost impossible to sell a franchise. Their reputation and the Internet transcend their false promise.

The public, however, have difficulty differentiating between a dirty franchise and a clean operation even though most operate well. Therein is the cost.

The level of protection needed for the franchising industry should not be seen as adding unique costs or regulation to this industry, rather; effective protection should bring franchising in line with inherent costs already associated with other industries and regulation.

Corporations, IPOs, financial lenders, insurance agents, stockbrokers and other industries operate with similar costs to what is recommended. Industrial Relations have inexpensive and fair dispute resolution processes similar to those being recommended.

The committee needs to consider all of the costs associated with the consequences of the existing framework including those to suppliers, lenders, landlords, health care and government agencies that support the victims.

We haven't been measuring the failures or the costs. Like a poor businessman we have been measuring our gross revenue and neglecting the net effect. A small element of franchising has been allowed to attack the bottom line of franchising and force the Australian public to bear the cost simply because they can under existing law and regulation.

"Consequently, the Committee considers that the costs associated with any additional uncertainty would be limited and would largely be of a transitional nature.

The fears of uncertainty and their potential costs have to be seen against the backdrop of the very real economic and social costs currently involved in the continued unfair exploitation of small businesses by larger businesses."

Para 6.41 Reid Committee Final Report 1997

A long-term strategy for franchising needs to be thoroughly investigated and through such an investigation I am certain that it would be concluded that ensuring confidence in this industry is critical and tied to legislative protection and the elimination of rogue franchising.

What is at stake is the cost to existing and future franchisees and the full potential economic and consumer benefit from this industry. There will be minimal cost to legitimate franchisors that would mostly comply with new and effective legislation already and where serious disputes do not exist.

There would be a difficult period for those franchisors whose operational methods, franchise models and documentation are questionable but the rest of the industry should not have to cater to the few that abuse franchising and those that profit from such behaviours.

8. Observations and Recommendations

It has been suggested that a submission should not recommend too much as inquiries will usually not deliver wide-ranging reform. That would be a sad indictment of Australian legislators. In early 2004 when I first approached a federal representative I was advised; *"walk away, you are up against the big boys and you cannot win"*.

Where there is indisputable need and avoidable harm to innocent Australians it should be dealt with and I would firstly suggest that if this inquiry needs more time it should have it.

Great emphasis has been placed on the impact of the Mathews' Review and recent changes to the disclosure provisions of the Code. The Mathews' Review only considered part 2 of the Code and the government of the day ignored even some of those recommendations. Recent changes to disclosure requirements while positive have not and will not satisfy all practical disclosure needs.

A good faith provision is now widely accepted as fundamental however, for any government to believe that alone will be a franchising cure-all exhibits a lack of understanding of the broad issues involved.

The following recommendations are based on preferred international practices in place today, recommendations of previous inquiries, analysis of publicly recognized franchising disasters and my knowledge of franchise opportunism.

Parts of these recommendations can be closely compared to parts of the *Financial Services Reform Act 2001*. More specifically, to the introduction of a new franchise licensing regime, minimum standards of conduct, new disclosure requirements, statements of advice, due diligence guides and penalties.

I believe this to be a basis for best practice and would deliver security to all participants in franchising and portray Australia truly at the absolute forefront of world's best practice.

(i) **Franchising Law**

Lawyers continually challenge definitions, terms and parts of the Code, or worse; the ACCC and lawyers acting for franchisees conclude that existing law often makes for expensive justice and therefore out of the reach of franchisees.

This situation is untenable and whilst in line with much of similar, inadequate, western franchising law it must be addressed; the law must be clear and address evolving needs.

I suggest it is unacceptable to produce effective law to protect future franchisees where a threat to existing franchisees is ignored.

Effective law does not create increased litigation; it changes the behaviours of those who would otherwise harm the innocent and it minimises conflict.

I recommend that Legislation;

a. *Create a franchising specific law.*

This was put forward in 1986 with 2 drafts of a Franchise Amendment Bill and then again in the Reid committee considerations, there is now clearly a need to finally produce a franchising specific Act.

The Reid Committee dropped the idea of introducing such an Act due to concerns relating to the cost to government. Now this committee must consider the cost to Australia if franchisees are not protected and the franchising industry is forced to sustain ongoing media and Internet damage.

Governments are charged with a responsibility to make moral decisions and to produce a healthy economy for the welfare of its citizens. The Reid Committee made their final recommendation based on ease and cost without consideration to the welfare of all Australians.

Previous inquiry outcomes, more than 32 years of victims, the ease and effectiveness of the Internet and moral outrage now bring new considerations to the table for today's lawmakers.

The committee should not consider the franchising relationship in terms of typical commercial contractual relationships. The franchising relationship carries an inherent imbalance of power in a number of areas and these do not exist in other commercial relationships. This relationship has unique needs and needs specific law.

- b. *Create a franchise specific regulator.*

This too was previously recommended in line with the needs of a franchise specific Act.

- c. *Incorporate a system where new franchise concepts must register an acceptable prospectus with the regulator or ASIC.*
- d. *Incorporate a system of registration for franchisors.*
- e. *Incorporate a system of registration for franchisees.*

This is in line with existing requirements within the Financial Services Reform Act 2001.

- f. *Ensures effective and mandatory due diligence processes for franchisees. A sample format is attached as Appendix B.*
- g. *Incorporate a system of registration for franchise agreements.*
- h. *Incorporate a system of registration for disclosure documents.*

Whilst it would be an operational nightmare to expect that a regulator could review registered documents, having them as an electronic file is not a burdensome task and would facilitate easy access by a regulator when necessary and importantly, would act as a deterrent for those that would otherwise ignore legal requirements.

- i. *Create dispute resolution processes through a franchising tribunal.*

Mediation can be successful but is easily abused by those who choose to. Franchisees that cannot afford civil action have not been able to access justice systems. This has been one of the main strengths and abuses of rogue franchisors over the franchisees that they have financially weakened.

- j. *Contain adequate and deterrent penalties including custodial sentencing guidelines for serious breaches of law.*

There are no effective deterrents or penalties for rogue franchising under the *Trade Practice Act 1974* or the Franchise Code of Conduct. Corporations, stockbrokers and many other industries all operate under regulatory frameworks where a breach of the law causing substantial suffering to innocent Australians allows for serious penalties.

When a master franchise is sold existing franchisees are not afforded any due diligence process and disclosure post-sale is worthless. A franchise tribunal and deterrent penalties in this case may be the only saviour where a [REDACTED] type scam operation is repeated.

k. *Impose a duty of fair dealing on each party.*

While those intent on resisting franchising reform will suggest that a good faith clause will do nothing to minimise disputes they discount the intent of such a clause where it acts as a deterrent and where, in instances of franchising opportunism, courts would be better armed to dispense just findings.

l. *Incorporate a clearly defined set of franchising specific examples of unconscionable conduct.*

This was asked for and the subject of recommendations of previous inquiries and will again be urged to this inquiry.

Franchising opportunism has operated within an understanding of the limitations of the Code, the TPA and the ACCC. The FCA seeks to dominate unavoidable reform;

“A clear and fair definition of unconscionable conduct under S51AC, preferably by legislation or guidelines developed in consultation with industry, so that the boundaries are clear and there is contractual certainty.”

Page 2 - FCA Submission to Trade Practices Act Review – June 2002.

Lawyers acting for franchisees, the ACCC and Courts have consistently stated that “*unconscionable conduct*” within the wording of 51AC of the TPA was too vague to apply in many cases.

I am suggesting that unconscionable conduct be given the meaning that was originally intended by defining acts that are unconscionable and thereby offer lawyers, the ACCC and Courts the ability that was intended under 51AC.

- m. *Incorporate a clause that states the where there has been non-compliance to legal requirements for due diligence and disclosure the franchise agreement to which the non-compliance is attributable will be void.*

In *Ketchell v Master of Education Pty Ltd* differing legal opinion and the concerns of the franchising industry identifies a need to clarify that legal requirements provide for an exit ability for either party where non-compliance has occurred.

- n. *Requires all notices of dispute issued by franchisors and franchisees and all franchisee/franchisor litigation to be registered with the ACCC.*
- o. *Incorporates a requirement for complete, detailed and transparent advertising and marketing fund annual reporting to be available to franchisees.*
- p. *Ensures the franchisee receives a copy of the current head lease where the franchisor holds the head lease on the franchise.*
- q. *Establishes the right of the franchisee to participate in lease negotiations.*
- r. *Ensures a communication requirement to the franchisor to inform franchisees of all and any alterations or additions introduced to the operations manual with 90 days notice prior to any additions or alterations becoming effective.*
- s. *Ensures an equitable process where a franchise network acquisition allows existing franchisees within the existing and acquired franchise a process of due diligence and disclosure with an option to end the franchise agreement without penalty.*

In the example set by [REDACTED] and the recent acquisition of [REDACTED] by [REDACTED], franchisees were excluded from any process of due diligence or disclosure when their franchise agreement was sold or where acquired franchises began operating in close competition with existing franchises.

Existing franchisees must be provided with a prospectus containing information as to the ability of the franchisor to efficiently conduct the business including a business plan, and any new or increased costs to the existing or new network including any re-branding options and costs.

In both the acquisitions, [REDACTED] and [REDACTED], franchisees were not provided with any information and were not aware of the proposed acquisition, or consequences, until after it had occurred.

- t. *Ensures that a franchisee is given 180 days notice prior to the expiration of a franchise agreement where it is the franchisor's intention not to renew the franchise agreement.*
- u. *States that confidentiality agreements are void other than to protect a franchise operating system.*

Confidentiality agreements involving rogue franchising are typically where the value of the settlement is in silencing a single franchisee to avoid growth in complaint and refusals to submit to unreasonable and unfair compliance. The target franchisee is generally bullied into accepting a choice between substantial loss or total loss.

Substantial loss usually being accepted and the legitimacy of disputes and their outcomes are hidden from the next wave of uninformed franchisees.

(ii) **Regulation**

The ACCC has historically performed a perfunctory regulation of franchising. While there has been recent and increased activity by the ACCC there are no substantial results that would support any belief that current legislation provides the ACCC with the necessary resources or law.

Many, and I agree, believe that the effective regulation of franchising would be a distraction from the ACCC role of regulating cartels, mergers, petrol and big business generally. A franchising regulator cannot be distracted from franchising's contribution to the Australian economy.

The franchise regulator to police franchising where;

- a. *A franchisor licence is acquired from the regulator.*

Under the present framework anyone with the funds can purchase an existing network. Anyone can establish a franchise. The franchise model does not have to work.

- b. *All franchise agreements, due diligence documents and disclosure documents to be registered with the regulator.*

Disclosure documents should be made available online. This was Recommendation 23 of the Matthews Report and would assist franchisees when comparing franchise offerings but would also enhance competition.

c. *A franchising tribunal adjudicates on disputes.*

To ensure inexpensive access to dispute resolution is to ensure that justice is accessible for the financially weak and in so doing, remove a number of strategies from the arsenal of opportunist franchisors and eliminate some of the attraction of such scams.

d. *All franchising breach notices and notices of dispute issued by franchisors against franchisees, all notices of dispute issued by franchisees and all franchisee/franchisor litigation to be registered with the regulator.*

e. *An adequately funded regulator is capable of performing effective, thorough and transparent investigations of complaints.*

f. *An adequately funded regulator is capable of running franchising test cases to better ensure the Australian franchising law is complied with.*

g. *The regulator effectively monitors franchise and franchisee statistical movement and cause.*

Further to these recommendations there is a need for the banking/finance industry to register franchising loans and provide such information, including arrangements with franchisors where such arrangements are associated with franchisee finance, to the regulator.

There is also a need for ASIC or the regulator to monitor prospectus submissions for new franchises and franchise acquisitions.

(iii) Due Diligence

Due diligence is generally not conducted effectively by prospective franchisees and often, not effectively by many franchisors as to the suitability of a franchisee candidate.

Most new franchisees, in both legitimate and rogue systems, will admit that they did not perform any real due diligence and the

decision to sign up was an emotional one. The opportunists does not perform due diligence of a prospect if he has the initial funding.

Franchisors sell franchises. They are salespeople. Salespeople encourage and guide people to make emotional decisions.

Websites and pamphlets relating the importance of effective due diligence play an important role; however, a smooth talking professional salesperson offering the exciting and fortuitous opportunity to be "accepted" to buy a "successful" smoke and mirrors franchise is much more effective.

Education alone has not and will not protect the \$130B franchising industry, or franchisees or franchisors. I have attached an appendix (B) [page 43] to this submission; "Your Franchise Due Diligence". No doubt it needs input; but it sets out the idea of systematic due diligence that offers protection for all participants including legitimate franchisors.

Whilst some may argue against such a format; the objective is to direct a prospect to the necessary level of transparency while exposing rogue systems.

I recommend that some form of list such as the one attached should be mandatory and registered.

Recent changes to the Franchise Code of Conduct assist to identify opportunism but more is needed to ensure that effective due diligence can be performed.

(iv) Disclosure

Further to now existing disclosure requirements under the Code there is additional information that would warn franchisees of the existence of franchising opportunism while continuing to protect a legitimate balance with franchisors' rights to confidentiality.

Franchisor Disclosure Document requirements also to include;

- a. Mandatory updating of disclosure documents annually within 60 days at the end of the fiscal year and/or within 30 days when an event not included in an existing disclosure document could be deemed to be significant and relative to effective prospective franchisee due diligence.
- b. A significant event would be one including but not limited to;

- (i) Litigation involving the franchisor
 - (ii) A recorded breach of law by the franchisor
 - (iii) Disputes between franchisor/franchisees where a critical mass of a minimum of 25% of a franchise network support the complaint(s)
 - (iv) Acquisitions by the franchisor that are associated with the industry serviced by the franchise network
 - (v) Complaints made to the ACCC
- c. Additional Disclosure Document information;
- (i) Franchisor financial reports for the previous 2 years in accordance with sections 295 and 297 of the Corporations Act.
 - (ii) A statement of franchisor solvency.
 - (iii) List of any other corporate entities where the franchisor is a director or partner.
 - (iv) Detailed annual financial performance (Profit and Loss statements) of the previous franchisee at a location involved in a sale to a prospective franchisee to cover the last 3-year period. Where the franchise was not operational for the required period confidential Profit & Loss to be produced for 3 like franchises established in the previous 5 years for an equivalent 3-year period.
 - (v) Itemisation of purchase price paid by the franchisor to the previous franchisee when franchises are acquired from a previous franchisee.
 - (vi) List of franchisees who are declared bankrupt at the time of or within 12 months of exiting a franchise system.
 - (vii) Full details of all disputes and litigation involving franchisees for a period of 5 years including;
 - (a) Issues in dispute
 - (b) Number of franchisees involved in individual disputes
 - (c) Names of Franchisees involved in each and any dispute
 - (d) Outcome or status of dispute
 - (viii) Full list of preferred and/or mandatory suppliers and all service and product categories subject to those suppliers.
 - (ix) Full details of all supplier rebates paid to the franchisor and details of utilisation of such rebates where the franchise agreement states that they support any franchisee benefit.

- (x) Detailed listings for any third party company or companies or individual(s) financially associated with the franchisor that provides any service or product to the franchise network.
 - (xi) Audits and detailed reporting of advertising funds.
 - (xii) A copy of the head lease agreement where the franchisor holds the head lease for the franchise.
 - (xiii) Details of all payments to the franchisor from a landlord for a franchised business.
 - (xiv) Franchise network territorial development strategy.
- d. In The Event of a Proposed Franchise Network Acquisition.
- (i) Franchisees within the existing and the acquired franchise network to be provided with a prospectus 90 days prior to such an acquisition outlining;
 - (a) The prospectus for the franchise, including
 1. All categories listed in standard disclosure
 2. A detailed business plan
 3. Detailed outline of new or increased costs
 4. Options to end the franchise agreement without penalty

(v) Sale of existing franchise networks

Where there is a sale of an existing franchise network the new franchisor will naturally want a healthy return on investment. When a rogue franchisor acquires franchisees they have to contend with an opportunist whose only interest is maximising a return on investment through such means as previously described in the [REDACTED] section 3(i) [page 6] of this submission.

These franchisees are excluded from even existing Code requirements for due diligence, disclosure and the opportunity to gain legal and accounting advice. Under the present regulatory framework they have no choice but to submit to the unknown.

They are not given an opportunity to access;

- The new franchisors experience,
- The viability of any change to the franchise financial model,
- Strategic business planning.
- How conflict between operating systems and operations manuals will be dealt with where the system is acquired by a competitor network,

- The performance and satisfaction of any existing franchisee network,
- Where there will be a re-branding of one network, what costs will be imposed on the acquired franchisees,
- How a new management system effects rental agreements and head leases,
- Whether there will be territorial conflict,
- How managed advertising funds will be fairly treated and/or amalgamated,
- Any option to end the franchise agreement,
- Any loss of goodwill on the termination of the franchise agreement.

I refer to the recommendations on this topic made in sections 8(i)s [page 28] and 8(iv)d of this submission [page 33].

(vi) End of term

There has been an ongoing misconception regarding some franchisees not understanding that the franchise contractual term is not infinite and that many complaints result from that misunderstanding. From my experience this is inaccurate and misleading.

Franchisees do know that if they do not comply with the standards and the system their franchise agreement may not be renewed. They know that the franchise agreement can be terminated prematurely on the same grounds. All franchisors, good and bad, inform franchisees of these basics very clearly and the good franchisors do because it is a obligation to the brand and the investments of all.

Where complaints have occurred in relation to end of agreements they have almost always been due to opportunism and often where an agreement is terminated on concocted grounds or where the franchisee did not understand the implications of end of term conditions and/or lease effect.

Opportunist franchisors do;

- Concoct grounds to terminate a franchise, treating compliance issues differently between complaining franchisees and those that do not complain, taking the business and the goodwill, and/or
- Include in franchise agreements, a clause that prohibits the franchisee from trading within a territory at end of term. This

effectively allows the franchisor to simply take the goodwill that the franchisee developed in the business, and/or

- Control a head lease whereby when the franchise term ends the franchisee must move out effectively allowing the franchisor to simply take the goodwill.

End of term conditions are a problem in “take it or leave it” contracts where inexperienced legal advisers do not warn of the historical potential of such opportunistic clauses.

My recommendations on this topic are mentioned in sections 8(i),j,k,l [page 26] and section 8(iii) [page 30] of this submission and with reference to the Appendix for Due Diligence [page 43].

(vii) The franchise tag

“You cannot legislate against stupidity” is a regular quote from those against franchising reform and while you cannot argue against it, we cannot accept that manipulating the stupid represents all of the evils of rogue franchising.

All major franchise brands were once new ventures but not all new ventures become major brands. An element of the silent majority of small franchise networks in Australia needs to be put into perspective.

I recently reviewed a franchise offering for a small franchise, [REDACTED], where very little resembled the requirements of the Code. To be brief, there was no disclosure document and the franchise agreement was notable for its omissions. An example would be that this was a territory based mobile service where the franchise agreement made no mention of a territory. There was no mention of the Code, no requirement to gain legal or accounting advice and no cooling off period.

This franchise offering included initial training and very little else other than a royalty and advertising fee. This is a franchise that is only attractive to the naïve because it is tagged as a franchise.

With very few franchisees the franchisor revenue obviously cannot provide for ongoing training or real support and it was unlikely the franchisor had any support capability. There was no evidence that any form of marketing was performed. A small network such as this has virtually no added buying

power. The franchisee pays for an unimpressive system and a colour scheme. Franchisees report a "minimum wage; in good weeks" after outlaying \$50,000 for set-up and franchise assignment. They are in trouble.

None of these franchisees knew of the Code of Conduct or that the ACCC was the regulator of franchising and the ACCC does not know of the existence of this franchise. Not one franchisee was prepared to lodge a complaint for fear of losing their investment.

In the case of [REDACTED] at [REDACTED] coffee shop franchise; he sold 7 franchises for between \$250,000 and \$450,000 each to unsuspecting immigrants and then simply left the country.

The point being that anyone can start a franchise. Call a business concept a franchise and the potential market for victims of the con increases dramatically.

A requirement to produce a prospectus and register would eliminate many of the charlatans. Refer to sections 8(i), (ii), (iii) [pages 25-30] of this submission.

One would also hope that such requirements would assist to eliminate franchise concepts where poorly considered long term rental levels produce unviable financial models that then destroy franchise networks.

9. In Conclusion

Current and prospective franchisees are typically middle-aged small Australians that have their entire life's savings at risk when they invest in a franchise. While Internet research, ACCC, FCA and various academics suggest varying statistical information on levels of franchisee disputes ranging from 2% to 35% of the industry; it is estimated that almost 6% of today's franchisees in Australia, representing in excess of 4,000 franchisees, are potentially under threat.

Franchising opportunism has the potential to cost Australia considerably more than the cost of effective regulation.

The reputation of every legitimate franchisor should not be tarnished by the 6% who make up their own rules to accommodate and manipulate inadequate Law.

Many have lost everything, lives and families shattered, where many could have been saved if the damage had been addressed following previous

inquiries. Some will refer to the victim franchisees as statistically insignificant; an acceptable level of collateral damage, I would argue that every single life destroyed is significant and those who suggest otherwise display the psychopathic personality traits we witness in the rogue franchisor.

No one knows how many franchisees or franchise networks have suffered total or substantial loss since the 1997 inquiry. No one was counting. We estimate that the number far exceeds 4,500 victim franchisees with families, employees, suppliers, creditors, health issues and government support.

The 1997 findings referred to suicides. There have been more but again, the figures are not conclusive because no one was counting.

I am confident that the inquiry will receive submissions relating to deficiencies in good faith dealings in retail tenancies where some franchisees are also subjected to landlord abuses of their more powerful position, and collusion with franchisors, particularly in relation to shopping centres. This adds to the complexity of the problems faced by this inquiry but it also must be considered as a contributor to injustice.

North American authorities in franchising disputes tell us governments are incapable of providing effective protection to franchising and the only alternative they recommend is to warn people away from the industry.

In 2005 I wrote to a group of franchisees and advised; "give me legitimate victims, suffering, a bad guy and a refusal to help by government and I will get your network media involvement." As long as law allows this to continue it will feed the damage to the reputation of franchising. The committee should not look to the many victims or franchising opportunism but rather, the patched up compromise that is franchising law in Australia.

Australia would now need to exhibit a morality and will that has eluded previous governments and other western governments.

The Internet and its future influence must now be a new consideration for lawmakers who are to decide the health of this industry.

In Australia many suspect that our franchising industry will undergo severe damage at the hands of opportunism if this inquiry fails. Growing Internet exposure and ongoing media coverage should not be ignored. Such a result will cost legitimate franchising and the economy of Australia.

The final yardstick for lawmakers must be to question whether they would purchase a franchise in Australia in 2009 without access to adequate due diligence and where law does not provide effective protection or deterrents in an industry where only one party to the franchise relationship has affordable access to justice and representation to government in addition to the uncertainty of a potential sale of the franchise network and where growing media coverage of franchising disasters endangers the investment.

I thank the Committee and advise that I wish to assist should there be any questions relating to my submission or franchising in general.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Ray Borradale', written in a cursive style.

Ray Borradale
18 August 2008

Appendix B

The following is the format referred to in this submission section 8(iii) [page 30]. It is put forward to simply prompt ideas for better due diligence and evaluation of disclosure information. Better law and regulation would also be cause to review such a template.

Your Franchise Due Diligence

Performing an effective Due Diligence of a prospective franchise business venture is often replaced by emotional decisions kindled by those selling the franchise and an unrealistic assumption that franchising offers automatic success. Buying a franchise typically carries a financial burden where you may well be placing your home and savings at risk if the venture fails.

It is critical that a franchise venture is investigated thoughtfully, thoroughly and unemotionally. Here you pursue an investigation through prompts designed to assist you to determine the likely success of the venture and the relationship you will have with your proposed franchisor.

Franchise Background

1) Contact(s)

[Provide the name(s) for the business operator(s)]

[Provide the entity name for the business.]

[Provide the telephone numbers for the business operator(s)]

[Provide email address(s) for the business operator(s)]

2) Business address

[Provide the address for the proposed/existing franchise.]

3) Business/Franchise name

[Provide the name for the Franchise and the location i.e. suburb, town or branch name.]

([Select/Type Existing or New] Franchise business.)

4) Location

[Explain why you have chosen this location.]

Due Diligence

5) Franchisor(s) name(s) & experience

1. [Provide the name for the franchisor and his/her industry and franchising experience]

2. [Provide the name for the franchisor and his/her industry and franchising experience]

3. [Provide the name for the franchisor and his/her industry and franchising experience]

6) Key franchise support people & experience

1. [Provide the name for the support person and his/her industry and franchising experience]

2. [Provide the name for the support person and his/her industry and franchising experience]

3. [Provide the name for the support person and his/her industry and franchising experience]

4. [Provide the name for the support person and his/her industry and franchising experience]

7) **Franchisee obligations and compliance**

[Describe your understanding of the franchise relationship.]

[Describe your understanding of franchisee obligations to the franchise brand.]

[Best describe how you can add your "style" to the success of the franchise.]

[Best describe your responsibility to the success of the franchise.]

8) **Existing/past franchisee contacts**

List 10 past and 6 existing franchisees and contact them to gain an insight into the success of the franchise. Most existing franchisees are reluctant to criticise their franchise system for various reasons even when a criticism is legitimate so it is important to contact at least the recommended number of past franchisees. Enthusiastic and positive responses usually indicate a content franchisee.

Contacts should be randomly selected by you and not prompted or offered by the franchisor or existing franchisees. If the franchise network is large (80 plus), it is recommended that at least 20 contacts be made.

It is crucial that you record and are satisfied with answers to the following questions:

1. [Franchisee name, telephone number and status (existing/past franchisee)]

[Franchisee response - How would you describe the format and frequency of franchise network **meetings**?

[Franchisee response - What type of **advertising** is provided?]

[Franchisee response - What is the format of reporting for **advertising funds**?]

[Franchisee response - What level of **local advertising** expenditure would be normal?]

[Franchisee response - How would you describe initial **training** and ongoing training?]

[Franchisee response - How would you describe initial and ongoing **support**?]

[Franchisee response - What level of supplier **rebates** does the franchisor receive?]

[Franchisee response - What level and type of product is **purchased** from the Franchisor?]

[Franchisee response - Where do you experience the greatest **buying power** benefits?]

[Franchisee response - How would you describe costs relating to a **lease**?]

[Franchisee response - How would you define the franchise **territory**?]

[Franchisee response - What unforeseen **costs** should be expected?]

[Franchisee response - How much **time** would be spent in the business in an average week?]

[Franchisee response - How would you describe the average franchise annual **net profit**?]

[Franchisee response - How does the franchisor support the **sale** of existing franchises?]

[Franchisee response - How would you describe the levels of franchises **sold** and long-term franchisees?]

[Franchisee response - How would you describe the type and level of franchisee **complaints**?]

9) **Franchise Internet research**

[What information was found through Internet searches at the ACCC and legal websites (Austlii)?]

[What were the outcomes of Internet and media searches?]

10) **Financial model**

[Provide the name(s) and telephone number(s) of your accountant and/or business advisor.]

[Are you and your accountant satisfied with your Cash Flow and Profit/Loss projections for the franchise?]

[What information was provided on the financial effects of rent and future rent projections?]

[What information was gathered on the financial effects of achievable costs of goods?]

[What information was gathered on the financial effects of product purchased from the franchisor?]

[What information was gathered on the financial effects of staffing costs?]

11) Franchise agreement

[Provide the name(s) and telephone number(s) of your legal advisor.]

[Is your lawyer satisfied that the franchise agreement meets legal requirements?]

[What questions, if any, were raised when the Lease was examined?]

[What questions, if any, were raised regarding end of term effects to goodwill?]

[What clauses, if any, to the franchise agreement require more explanation and why?]

12) Lease

[You have read and have a copy of the head lease; what questions are raised for you?]

13) Finance

[What issues were raised for you when you compared levels of interest and payments?]

14) Franchising Legal Requirements

[You have read the relevant legal requirements for franchising; what questions are raised for you?]

[You have read the relevant legal requirements for franchising; which clauses hold significance and why?]

[Who provided you with any clarification of legal requirements?]

15) Future franchise prospects

[What research outcomes performed by you indicates a long-term future for the Franchise Model?]

16) Franchisor obligations

[Describe the key obligations of the franchisor to the franchisee.]

17) Franchise Information - General

[Was there any information provided to you that was found to be inaccurate? - provide details.]

[List any other information you believe is required to support a decision to accept this franchise offering.]