

SUBMISSION

by

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to

**Parliamentary Joint Committee on
Corporations and Financial Services**

**INQUIRY INTO
FRANCHISING CODE OF CONDUCT
& OTHER RELATED MATTERS**

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1. INTRODUCTION

I appreciate the opportunity to submit my comments in relation to the operation of franchised business to the Parliamentary Standing Committee on Corporations and Financial Services. I am available for clarification and further comment should the Committee so desire.

I will attempt to adhere to the "Terms of Reference" where possible; however, with regard to my particular case, some aspects fall within the criminal code. Moreover, my franchise experience is representative of the need for a tightening of the "Franchising Code of Conduct" together with a concentrated and improved enforcement of the Trade Practices Act. It is also apparent that the dispute resolution processes are by in large ineffective and exploited through the unequal distribution of power in the franchise relationship. I have attached for the Committee's consideration, a chronology detailing some of the events that I experienced in the lead up to the termination of my franchise agreements.

First and foremost, I am not against franchising and it is pertinent to point out that I believe the Franchise concept has many benefits to the individual small business operator (the Franchisee) and the wider community. It is also evident that not all franchisors adopt dishonest business practices or engage in conduct designed to destroy the livelihood of their franchisee investors.

However, the current legislative provisions, both State and federally, and the Franchising Code of Conduct are inadequate in a number of areas and do not protect the small business operator from unscrupulous and powerful franchisors. The "peak body", The Franchise Council of Australia, does not appear to be an objective independent body, moreover, it displays bias toward the franchisor.

At present, the remedies currently available when a dispute arises are MEDIATION and LITIGATION. These are extremely cost prohibitive, especially where the franchisee is in financial difficulty or the franchise agreement is terminated unexpectedly, resulting in the immediate and often catastrophic loss of the family's income. The Franchisor, by virtue of the business relationship is the more powerful party and is in the position to manipulate the results of mediations. Often the financially devastated franchisee is positioned in such a way that they have no option other than to accept a poor settlement. Inevitably this always comes with a confidentiality waiver attached, meaning that the franchisee (being the weaker party) does not get the settlement without the waiver. There is strong evidence to suggest that Franchisors do not attend mediation in good faith, with some simply attending mediation to get "the tick in the box", to be seen to comply with the Franchising Code of Conduct.

Additionally, the franchisor can maliciously drag out litigation as they have the cash reserves to ride out the franchisee. This can be evidenced by the fact that we rarely see successful litigation against a franchisor in Australia. The average cost of proceeding with litigation is in the vicinity of \$500,000 and more if the bank is also involved. This, in reality, is out of reach of most Australian families who make up the franchise small business industry.

Further, the Franchising Code of Conduct is irrelevant and often ignored by franchisors because there are no penalties imposed for breaches.

The Franchisee pays a premium price to purchase the franchised business and its systems. That together with the advertised and promised success of the franchise business is what attracts a proportion of first time business owners. The Franchisee pays training fees of up to \$10,000 to be trained in all the fundamental requirements to successfully operate the business. The franchisee also contributes royalties and marketing levies on a weekly basis, based on percentage turnover. The marketing levies are paid for the franchisor to market and grow the business, provide expert advice and support to the franchisee.

It is evident by the number of business failures that the franchisee is somewhat exposed and is simply paying for a service they are not getting. Additionally, the number of business failures in franchising has reached unacceptable and epidemic proportion.

Moreover, there are large numbers of profitable businesses being deliberately sent to the wall by unscrupulous and greedy franchisors and banks who are "churning" businesses for considerable financial gain thereby stripping franchisee of their business and personal assets. This has created a paradigm shift that has become the universally accepted norm. Furthermore, Franchisees now have to come to terms with the abhorrent reality that a number of major banks are involved and are engaging in behaviour that is not only lacking in a duty of care to its franchisee clients, but is in fact conduct intimately connected and consistent with malpractice.

I have been systematically stripped of all that I have worked for my entire life. I have been left with impending bankruptcy and my impeccable credit rating has been completely obliterated, a circumstance that was completely engineered by my franchisor ██████████ Holdings and the ██████████. ██████████ has conducted themselves in the same manner with multiple franchisees all over Australia over the last 4 years.

██████████ opportunistically breached me when they knew the cash flow was reduced as a consequence of the shopping Centre refurbishment; contributed to and manipulated my business position to enable them to take control of my stores.

[REDACTED] inconsistently applied the franchise agreement when dealing with my company. They only breach you out if it suits their objectives.

A franchisee can lose their business, home and life savings over a cracked tile or the late payment of an account, yet the High Court can overturn a ruling against a Franchisor for a 'technical' breach of 'The Code' with no penalty being applied.

Finally, this incident, I believe, sums up the mentality and lack of morals and ethics some Franchisors maintain. My husband phoned [REDACTED] the CFO and asked him why he was doing this to us. [REDACTED] reply was: **"because you don't get on with your State Manager"** and **"because we can"**.

2. MY [REDACTED] EXPERIENCE

I was a franchisee of [REDACTED] Holdings Pty Ltd for a period of 7 years between July 2000 – February 2007. I owned and operated two stores. My experience with the franchisor was less than satisfactory and can best be described as a nightmare; one that I have not recovered from some 18 months on. My family has been systematically stripped of all our business assets and lost our family home and our life's savings. We have been physically, emotionally and financially destroyed through our involvement with [REDACTED] Holdings. My husband suffered with major depression. We are now separated and my children have not seen their father in almost 2 years.

Unbeknown to me before I purchased the business, I was to be caught up in a web of lies and deceit during my 7 year involvement with [REDACTED] Holdings, its business partners, including the [REDACTED]. I experienced constant and persistent harassment and poor conduct including but not limited to the following:

- Lies and misrepresentation
- Inducement to spend money for refurbishments with the promise of a ten year franchise term. Failure to deliver that promise resulting in major financial losses
- **Collusion/conspiracy** and breaches of privacy with suppliers, banks and landlords designed to create financial duress, destroy the business and induce a breach of the franchise contract.
- Bullying, intimidation, threats and defamation
- Use of private investigators to monitor me whilst still in the system and when exited from the system, including having private investigators parked outside my place of residence on a regular basis.
- Exclusion from the franchise group
- Withdrawal of support, no provision of qualified expert advice
- Inappropriate/fraudulent accounting, inaccurate debtor statements invoices added and failure to provide honest reconciliations for shop fit outs.
- Withholding money owed to my business to affect cash flow and induce breach of contract
- Franchisor refusing to mediate and ignoring notice of dispute
- Restriction of trade
- Induced breaches of contract to cause financial duress and take control of the asset.
- Theft of stock and equipment
- Pressured to do things against my will, including signing documents - both the Bank and [REDACTED] took part in this.

- Failure by [REDACTED] to purchase my franchised businesses, upon their termination of my agreements, at fair market value thus inducing financial catastrophe.

2.1 Misrepresentation and inducement to commit funds

In 2003 [REDACTED] represented to me that if I became a multi-site operator and purchased a second store that they would extend the franchise agreement of that store out to ten years. This was promised as a condition of me purchasing the business so that I could recover my financial commitment over the 10 years. Based on that representation, I committed \$500,000 to the purchase and refurbishment of that business and made business decisions based on those representations.

[REDACTED], reneged on that and induced a breach of contract through collusion with the bank.

Evidently, franchise loans are aligned to the franchise agreement, if one does not have a franchise agreement one cannot have a business loan. At this point, the bank can call up the loans and or refuse finance. In my case, finance that was critical to the success of my business during a renovation was refused due to the non provision of the franchise agreement.

Further, my lawyers tried for many months to secure the promised franchise agreement as represented, this cost my small business in excess of \$70,000 in legal fees; money that [REDACTED] knew that I did not have and that my business could not afford. Having to take this money from my cash flow had a dramatic impact on my business.

My solicitor's intervention, eventually led to [REDACTED] agreeing that they would extend the agreement by 5 years. Four (4) days later they "changed their minds". [REDACTED] informed my lawyer in writing that it was too difficult to draw up a contract for five years. Ironically, however, they could draw up contracts for one year or ten years. Evidence and testimony of this was provided to the ACCC. ***Evidence and testimony provided to the ACCC.***

2.2 Collusion

[REDACTED] Holdings and the [REDACTED] used their ongoing and interrelated business relationship to the detriment of my small business. The result was that between them, they effectively took a sledge hammer to my business and

intentionally sent my business into receivership. Private and confidential information was passed between the Bank and [REDACTED] without my permission.

The [REDACTED] and [REDACTED] were complicit and conspired to induce a breach of my franchise agreement. In fact, the [REDACTED] knew before I did that my franchise agreements were to be terminated, yet they failed to use proper "duty of care" by not informing me of that fact or advising me of all my financial options. The [REDACTED] in cahoots with [REDACTED] made decisions about my business and that were knowingly detrimental to my business.

The [REDACTED] accepted [REDACTED] written down business valuation when they loaned me the money to buy the two businesses. Similarly they accepted [REDACTED] significantly reduced business valuation at receivership 7 years later. They consciously aided [REDACTED] in the despicable act of rolling over my profitable businesses with the intention of sending them to the wall. I lost my entire business value and goodwill which were independently valued at \$1.5M. Additionally, I lost future potential earnings of those growing businesses.

In March 2007 [REDACTED] and the [REDACTED] got together to do a deal where the Bank accepted [REDACTED] written down value of \$220K for the two shops.

I purchased these businesses for about \$900K and refurbished them at an additional cost of \$180K (making my commitment over \$1M). The paltry sum of \$220K amounts to less than the value of the equipment. I received nothing for my company's goodwill.

In essence the [REDACTED] aided and abetted [REDACTED] in stealing my assets by opportunistically working together to create financial pressure by devaluing my businesses.

[REDACTED] are now free to sell or lease out both businesses again and the [REDACTED] can now rewrite the loans and repeat the process all over again.

2.3 The Bank

The [REDACTED] unlawfully tampered with my bank accounts; rearranging the accounts, removing deposits and adding debits often up to a week after the fact. This conduct went on for about 12 months in the lead up to my termination. Of course this would

always result in some sort of fee or charge being debited from my account designed to add further financial pressure.

In addition, the [REDACTED] withheld, for no legitimate reason, banking facilities that were vital to the sustainability of my business moving forward and through a shopping centre refurbishment, further impeding my cash flow. This went on for 18 months. The [REDACTED], at 12 hours notice, also froze the use of my banking facilities (business and personal), including internet transactions making it impossible for me to pay staff wages and my bills. Details of which can be found in the attached chronology. Evidence and testimony of these facts were provided to the ACCC.

In October 2007 the [REDACTED] issued a Notice of Default and repossessed our home which had an estimated market value of about \$950,000. The house was left vacant for 7 months and was not occupied until after the ACCC handed down their decision in the [REDACTED] investigation in May 2008.

They absorbed all of my equity through added liquidation costs of about \$120k and they passed on all legal fees of around \$100,000. They ensured that every cent was taken from me at liquidation. I got nothing from \$2.45M of assets.

I was not informed by the Bank or [REDACTED] until Dec 2007 what [REDACTED] paid the Bank for the businesses, this information was reluctantly supplied because I hounded them for it. Additionally, I was not informed by the Bank in regard to what was paid for my home or the disbursement of the sale proceeds until Jan 2008

In my opinion, the [REDACTED] and [REDACTED] have *gained considerable financial advantage by deception.*

2.4. Mediation

I was engaged in an unresolved dispute with [REDACTED] about my franchise agreement renewal - [REDACTED] were, in my view, being unreasonable. Consequently I instructed my lawyers to serve [REDACTED] with a "Notice of Dispute" under Section 28 of the Franchising Code of Conduct. [REDACTED] ignored my Notice of Dispute and moved, taking possession of both businesses on the 27 February 2007.

I had no other options available to me other than contacting my local member of parliament. Only then did [REDACTED] agree to mediation. We eventually went to mediation in May 2007 at a cost of over \$5,000 to me. I am bound by a confidentiality

agreement so cannot say too much about it, other than to say that [REDACTED] did not enter the mediation in good faith, but were "being seen" to comply with the code of conduct and "got the tick in the box". I was offered the obligatory pittance which I declined.

Evidence and testimony of these allegations were provided to the ACCC.

2.5 Termination of agreement

After an extensive, ongoing and unresolved dispute and the serving of the "Notice of Dispute". On 27 February 2007, [REDACTED] Holdings took control of both my stores situated at Karrinyup and Belridge and changed the locks. They had also brought with them security guards. The [REDACTED] representatives informed the staff, their parents and my customers that our businesses had gone bankrupt - which was an absolute lie.

I was oblivious of the situation until a routine phone call to one of my businesses when I was informed by a 14 year old sales girl that the business was taken over by [REDACTED] and that the staff now worked for the company.

I immediately traveled to the Belridge store and informed the State Manager that I had not been properly terminated and informed him that he was ignoring my "Notice of Dispute". I quoted the relevant section of the code of conduct and I asked him to provide my termination paperwork forthwith. The termination documentation was served on my son at 7.30pm, some 3 hours after [REDACTED] had taken control of my businesses.

My 20 year old son was sacked on the spot by [REDACTED], the Regional Manager, my son had worked in the business since he was 14 years old.

[REDACTED] waited to take over my business until both the stores were fully stocked, about \$30,000 worth of packaging and ingredients together with about \$20,000 worth of camera equipment and other personal effects of mine which were never returned. The stock still has not been paid for though I have been left to pay that debt. [REDACTED] continued to trade at my stores and profited from stock I paid for.

[REDACTED] kept the profitable Karrinyup store and the income stream associated with it for themselves. They have now, 18 months later, leased the business out and are now receiving a monthly payment of about \$7,000 from the franchisee. In

addition, they originally leased the Belridge store, but it has now been sold. I don't know how much the store was on sold for, however even if they sold it for the \$100,000 they paid me, they have made a nice profit and they have essentially taken my Karrinyup business for free.

When ██████████ Holdings notified my Bank that my agreements had been terminated and that I was no longer in control of the business, the Bank sent my company into receivership in order to collect the business debt. As a result we lost our family home, our staff did not receive any of their leave entitlements and we now live with friends. In addition we have been left with supplier, vehicle, ATO and staff superannuation debt and no income to service it.

3. THE ACCC

The role of the ACCC in relation to franchising is a difficult one to define. However, one should be able to reasonably expect the Commission to promote and enforce a fair and competitive environment for the franchised business.

As it currently stands, all indications are that the ACCC is not equipped to deal with the volume of franchise complaints. It is also apparent that the ACCC is turning a blind eye and its inaction is contributing to the scandalous and criminal evolution of franchise "churning" and the exploitation of the weaker parties to the contract, the franchisee.

In early 2004 I approached the ACCC in relation to the behaviour of ██████████ Holdings toward my small business. At that time I was concerned that ██████████ was trying to reacquire my successful Karrinyup business and that they were trying to bully me out of it. I was informed by a representative of the ACCC that there had never been any complaints against ██████████ and there was nothing they could do for just one franchisee.

In early 2007, 3 years after I first approached the ACCC I had lost both my businesses to trade practice misconduct and franchise theft. I was one of 16 franchisees whose cases were presented to the ACCC by the Honourable Joanna Gash, the Federal Member for Gilmore. All 16 complainants experienced similar conduct in their relationship with ██████████ and its management which resulted in their complete financial collapse and emotional distress.

The ACCC conducted, over 15 months, what they describe as an in depth Level 3 investigation. "Investigation" is a misleading term that the ACCC likes to throw about to make one feel that action is likely to take place and it adds a level of importance to the ridiculously long time frames imposed upon the complainants to return a nil result.

During the in depth investigation, I was led to believe, by the ACCC enforcement people, that there were significant issues that resulted in the investigation progressing to that level. On one occasion I was even told that the ACCC had "serious concerns" about my bank's conduct. In addition, throughout the investigation, I handed physical evidence and testimony of fraudulent accounting and undisclosed "kick backs" for shop fit-outs, that not only involved ██████████ but several of their business partners.

Further, it was discovered that on exiting the ██████████ system, a significant number of the original 16 complainants, including my family, were subject to increased criminal activity including house burglary, a common theme was the theft of computers and mobile phones. Although this activity could be coincidental, the ACCC did nothing to investigate this allegation or hand it over to the appropriate authority.

The ACCC's enforcement people were informed early in the investigation that my family home was going to be lost to the bank to cover my business debt. I understand that the ACCC had the ability and the statutory powers to have prevented the loss of my home pending the outcome of the investigation. The ACCC did not choose to exercise these powers. Instead, they let my family endure the drawn out investigation process under constant threat of becoming homeless.

Throughout the investigation I became aware that the ACCC's enforcement team had limited understanding of the elements of unconscionable conduct and how this conduct relates to the Trade Practices Act. It became apparent that the ACCC conducted a low level "he said, she said" investigation without using any of its enforcement or statutory powers to properly and forensically investigate the trade practices of ██████████ Holdings Pty Ltd. Nor did the ACCC follow up on the allegation of collusion with the bank.

In addition, the ACCC failed to interview any of the witnesses put forward by the complainants or that were relevant to the allegations. This included a franchisee who told me 18 months before I was terminated that ██████████ was going to "breach" me out of the system. So the question must be asked, what on earth was the ACCC doing throughout this 15 month investigation?

Furthermore, the ACCC inconsistently applied the legislation. In a number of recent franchise cases they have deemed that 7 days to rectify a breach of contract is not enough. However, in the ██████████ case, 7 days was considered tolerable and was allowed to stand.

I also think it is mind blowing, that the ACCC let ██████████ know the outcome of their investigation weeks before the financially and emotionally destroyed complainants were informed. It begs the question, were ██████████ ever going to be found guilty of the allegations and how much communication actually went on between the ACCC and ██████████. Did ██████████ simply flood the ACCC with (*irrelevant*) correspondence, making the case too difficult, too time consuming and too costly to establish?

Further, on a number of occasions, I tried to contact members of the enforcement team only to be informed they went on annual leave, were out of the office or were overseas etc leaving the complainants, hanging.

Through valid deductive reasoning, I draw the logical conclusion that the investigation process was flawed and may have been susceptible to dishonesty.

In summing up the ability of the ACCC, one needs to look no further than a recent comment on the ABC Landline program by Senator Bill Heffernan and I wholeheartedly concur, "the ACCC is as useless as tits on a bull".

4. RECOMMENDATIONS

Due to the uncertain quality and nature of the ACCC's investigation into the 16 [REDACTED] complaints, I believe that it would be morally justified to refer those cases, together with any other similar complaints before the ACCC, on to the Privacy Commission for analysis.

Further, I offer the following recommendations:

1. A cost effective and independent arbitrary body established to deal with disputes.
2. Mandatory registration of all franchise agreements with ASIC or other independent body.
3. Litigation and mediation statistics be kept and provided at disclosure to prospective franchisees.
4. Outlaw and abolish exit fees.
5. Franchisees to hold leases, not the franchisor.
6. Franchisee to be included in all rent negotiations.
7. "Harsh and oppressive" clause to be upgraded and incorporate retrospective legislation for 5 years.
8. Provision of a "Good Faith" clause into the act.

5. CONCLUSION

Franchising, when correctly applied and in good faith can be a great way for Australian families to enter the small business sector. However, maintaining the status quo will result in the continued evolution of franchise fraud and misconduct.

Franchising can be a sophisticated and lucrative system for some franchisors and [REDACTED] is one such franchisor. [REDACTED] makes more money from selling businesses than it does from selling bread. The current state of affairs in Australia is that the market is saturated with [REDACTED] stores. There is currently no incentive for the franchisor to work with its franchisees as more money can be made by deliberately working against the individual operator and turning the business over. Most sophisticated operations have relationships with banks and suppliers, all working to keep each other afloat and the profits rolling in. There is no incentive for them to work independently of one another. I believe that in my case my bank was completely complicit and worked against me for over two years. The franchisor chooses their victims exit strategy carefully unbeknown to the franchisee and the current laws with the lack of suitable remedies allow it to happen.

All indications are that my franchisor ignored the Franchising Code of Conduct, breached the Trade Practices Act, in particular Section 51AC "Unconscionable Conduct" and "harsh and oppressive" conduct in their business dealings with my company. As it currently stands, unless I can raise about \$300,000 - \$500,000 to litigate against [REDACTED] and a further \$500,000 to take on the [REDACTED] there is nothing I can do about it under the current system. There is a complete lack of protection for franchisees. Furthermore, franchise "churning" yields great financial results for the franchisor and the banks.

Unless the Government acts to close loopholes in the Trade Practices Act and the Franchising Code of Conduct, franchisee families will continue to be fleeced and exploited. Particularly by franchisors, banks and landlords who appear to be devoid of any real moral compass.