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The Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Department of the Senate  
P O Box 6100  
Parliament House  
CANBERRA ACT 2600

### **Inquiry into the Franchising Code of Conduct**

Dear Sirs

This submission to the Franchising Code Of Conduct Inquiry is made on behalf of 720 franchisees in the [REDACTED] lottery franchise in Victoria. Sales in this franchise exceed one billion dollars per annum.

#### **Summary of this Submission**

The Association proposes that the Franchise Code be amended in the following ways: -

- There should be a requirement on a franchisor to act in good faith.
- The turnover-based exemption from the Code should be less generous.
- Unilateral variation of Franchise Agreements should be prohibited.
- Franchise Agreements should be submitted to an independent body for pre-approval against the requirements of the Code.
- There should be an Arbitration Tribunal for franchise disputes.
- The requirement to approve transfers of franchises within a certain time needs to be strengthened.

#### **1. Introduction**

The [REDACTED] lottery franchise is highly respected and even before the introduction of the Franchise Code there was comprehensive disclosure and a franchise agreement which was fair although very detailed with extensive controls on the businesses of franchisees.

The prescriptive nature of the [REDACTED] Franchise Agreement aimed to protect an already strong and reputable brand but was also necessary because of the nature of the products being sold i.e. lottery products sold under Government licence requiring absolute integrity and public confidence.

In November 2007, following a prolonged review, the Victorian Government decided to split the lottery licences in Victoria. This gave the right to operate some games to [REDACTED] Pty Ltd and left [REDACTED] with lottery games where the prize pool was consolidated with prize pools for the same games sold interstate i.e. Saturday Lotto, Super 7's, Oz Lotto and Powerball.

The establishment of new lottery licences by the Victorian Government necessitated the re-issuing of Franchise Agreements. In the course of reviewing the [REDACTED] Franchise Agreement and the [REDACTED] Retail Contract the Association became aware of issues involving the Code and franchising in general which are relevant to this Inquiry.

This submission therefore addresses aspects of the Terms of Reference by specifically focusing on our experiences following the introduction of new lottery licence arrangements.

## **2. Acting in Good Faith**

LAAV strongly urges the introduction of a requirement on franchisors to act in good faith. The new ██████ Franchise Agreement was far more prescriptive and demanding than the previous one and this reflected the franchisor's intention to take every legal step possible to prevent the competitor from "riding on the coat tails" so to speak of the strength of the ██████ brand.

Franchisees, some of whom had been in the ██████ network for decades, were presented with a "take it or leave it" document which had heavy penalties – termination for even minor breaches of the agreement coupled with an agreement term which in some cases was as short as six months and at best was four years.

Franchisees were in no position to reject the agreement because of the capital invested in the business. Many retailers found themselves being forced to agree to revise shop fits – in some cases costing upwards of \$30,000 – when they only held a short term franchise without automatic right of renewal.

On 1 July this year ██████ began operations in Victoria and immediately ██████ brought a heavy hand to bear on franchisees who displayed or promoted ██████ products in the area from where ██████ products were sold. They became dictatorial in the extreme over the approval of plans for new shopfits and in that regard frequently forced retailers to adopt shop layouts that produced inefficient point of sale processes. The end result is that ██████ prevented the competitor from "feeding off" the ██████ brand but for the franchisee the outcome was high shop fit costs; higher staff costs because of inefficient sales processes; and in many instances the franchisee lost sales through the separation of the selling points of products which were previously sold together i.e. lottery tickets and instant scratchies.

The Lottery Agents Association contends that these actions may not have been possible or would have been moderate had there been an obligation on the franchisor to act in good faith towards its franchisees. The Association is particularly conscious that the position ██████ franchisees found themselves in was not of their making and they have been greatly disadvantaged by the competition driven impositions.

## **3. Franchise or Not?**

The emergence of ██████ as a lottery operator in Victoria has so far been disastrous for retailers with a high sign-on fee, high fixed costs and low sales. ██████ relied on Clause 5.4 of the Franchise Code thereby avoiding the obligations of a franchisor.

Many retailers would not have taken on the ██████ contract had it been presented as a franchise because mandatory disclosure would have occurred and there would have been time for obtaining both legal and business advice. These safeguards were not available and retailers signed up for ██████ being fearful of losing sales of products they had sold successfully under the ██████ banner.

The ██████ retail contract has now been signed by around 750 retailers in Victoria and is so far proving to be a poor business decision.

When a comparison is made between the ██████ Retail contract and the ██████ Franchise Agreement there are very few differences in principle. The fee structure and commission structure are similar, the use of centralised accounting and sales process is essential, there is common marketing, and there is of course mandatory use of the central lottery processing system.

The Association believes that the so called 20% rule in Clause 5.4 of the Code has allowed [REDACTED] to avoid some fair and reasonable obligations towards its distributors and that part of the Code we urge should be amended. In the Association's view there should be further qualifiers e.g. exceeding a certain number of participants would make a commercial arrangement a franchise even where the turnover is less than the 20% referred to in the Code.

#### **4. Unilateral Variation**

The Franchising Code should prohibit the unilateral variation of Franchise Agreements and variations effected by changes to Operations Manuals. As mentioned earlier the introduction of new [REDACTED] Franchise Agreements came about because of the Licence Review process in Victoria but the Agreement was presented as "take it or leave it" although it was significantly different (harsher) than the previous agreement. Even now it is possible for the Agreement to be further amended without agreement by franchisees.

There is a substantial Operating Procedures Manual in the [REDACTED] franchise for which compliance is mandatory. A change to that manual, say in relation to the shopfit requirements can be in effect a major change to the franchise agreement and a major cost. Any directive that incurs costs changes the financial basis of the decision to enter that franchise and can have significant consequences. This would be avoided if unilateral contract variation was outlawed including variation to an operations manual which incurs franchisee costs.

#### **5. Pre-Approval**

It seems to the Association that Franchise Agreements should be subject to scrutiny by an independent expert body before they are offered to franchisees; in much the same way as a prospectus is examined by ASIC.

This would ensure that the agreements comply with the Code but equally importantly it would avoid the necessity for every franchisee in a group to seek legal advice about the agreement other than for specific business purposes. In the case of the new [REDACTED] Franchise there were 720 businesses that would have sought legal advice from their solicitors on exactly the same document – at \$1,200 each or thereabouts, that's a lot of money for the same job.

#### **6. Disputes**

The Inquiry will already know of the size of the franchise industry and the prevalence and gravity of disputes, which has been the major reason why there have been inquiries at State Government level and now this Federal Inquiry.

The Association has considerable experience with disputes going before the Victorian Small Business Commissioner. There have been numerous disputes arising from the introduction of a lottery competitor in Victoria – particularly relating to the use of counter space that was branded as [REDACTED] but used for [REDACTED] sales. These have been what we would call soft mediations in that they are generally not adversarial. As a result there have been many agreed mediation outcomes.

The Small Business Commissioner's processes do not succeed to the same extent however when an issue is aggressively pursued by one of the parties. The fact is that the mediation process only requires both parties to attend. It does not require either party to do anything but be there. To be successful, mediation requires there to be goodwill from both parties. When that is not the case then mediation fails. The Association believes there is a need for an arbitral authority with particular expertise in franchises to decide disputes with appeal only on points of law.

The Lottery Agent's Association would like to see an authority established with the roles of administering the Franchise Code, reviewing franchise documents before they are issued and being the arbitrator for disputes.

## **7. Expediting Franchise Sales**

The Association wishes to also bring to the Inquiry's attention the sometimes ineffectiveness of the 42 day rule – Franchise Code [20 (4)].

The transfer of ██████████ accreditations can sometimes take as long as six months – an impossibly long period for people who have left a job or sold a business and who are waiting for the approvals process to be concluded so as to buy a ██████████ franchise.

It is open to a franchisor to continually procrastinate by seeking additional information from an applicant – no matter how minor – then claim that the application was incomplete and that the 42 day rule does not begin to come into contention until there is a complete application.

It is perplexing that a business holding both an Australia Post Franchise and a ██████████ Franchise – a not uncommon situation – can be sold with the Australia Post Franchise transfer taking under six weeks only for the sale to be held up because the ██████████ Franchise transfer process takes substantially longer. The unfortunate result for the vendor is that they are stuck in a business that they have decided to move out of for maybe half a year longer than they intended and often times prospective purchasers walk away from the deal because they simply can't afford to wait that long to buy a business.

The Association understands the 42 days prescription was introduced to ensure that changeovers of franchisors occurred without undue delay. An overly inquisitorial process can defeat that intention where demands for more information are unreasonable and are arguably unnecessary. The Code needs to be strengthened in this regard.

The Association would be pleased to provide further information if that assists the Inquiry.

Peter Judkins  
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Lottery Agents' Association of Victoria