

14th July, 2008

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

Submission to the Inquiry into the Franchising Code of Conduct

The import of the words which follow may not be crystal clear, the subject matter may jump all over the place, there may be too much detail or not enough, but it is all true, and my recommendations are predicated on bitter experience, much of it my own. I am more than happy to be contacted to explain or elaborate should that be thought desirable, either in writing, by telephone, or even in person (since I work in Canberra it would be little trouble).

Recommendations that I would draw from that which follows – and bear in mind that none of them would be onerous or have any effect, financial or otherwise, on franchisors that do not get involved in disputes – are:

- A specialised unit/department/authority to oversee franchising. The current situation with the ACCC is worse than useless, and the body that should do it is certainly not the Franchising Council of Australia. Self-regulation does not work. The ACCC and the FCA are both part of the problem.
- The Franchising Code of Conduct (FCC) needs penalties, and not just financial ones (which, as it should be perfectly obvious, are no deterrent), and more particularly it needs to be enforced. Complaints need to be investigated by people with appropriate powers, and the onus of proof should not be on the complainant (usually the franchisee).
- There needs to be a dispute resolution process. That process must be affordable to the franchisee, and not of the form of the current unequal Mediation contest. That current process is totally flawed because the franchisor can, and does, turn up with a team of lawyers against a lone franchisee, the mediator cannot make orders, and there is no requirement whatever to act in good faith since any agreement reached is easily broken

without penalty; in fact by either party, but the reality is that it is always the franchisee who is the loser. Against feral franchisors, who are the only ones likely to be involved in Mediation anyway, the process is a complete waste for the franchisee; for him it is a no-win situation.

- Franchisees need to be able to have a say in what is happening in the organisation in which they have a financial interest. Franchisees have invested their life savings, or more usually their house, in a business that is theirs in name only, or not even; they have no more authority than a manager without the luxury of a 9 to 5 job, and no more security. The business relationship should be a partnership, not 21st century serfdom.
- It should not be possible for the franchisor to rewrite a Franchise Agreement under the guise of introduced "operating standards". Any operating manual, once again in recognition of the partnership, this should be by common agreement, or at least by consultation.
- The current situation where a Franchisor still collects royalties when a Franchisee is losing money need to be addressed. Royalties must be based on profits only (rather than turnover, which is iniquitous); it is not "too hard", everyone has a computer.

I am aware that the exit provisions surrounding the expiry of a Franchise Agreement, where an unscrupulous Franchisor can effectively take back a franchise for a song, leave much to be desired, but... I never got that far.

My submission (more or less) to the recent WA and SA enquiries into franchising follows this. You might read that first, although I suspect it will differ only in inconsequential detail from other franchising horror tales you will read, or even less than that from one that could have been told by any of the 80 – 120 failing [REDACTED] franchisees before I joined (nobody really seems to know how many, or those who do know will not admit it), or from goodness knows how many since.

That submission was written some six months ago. Since then:

- The [REDACTED] franchise I bought (in Mona Vale, NSW) was, after I left, re-opened as a company shop, again sold again to a franchisee... and closed again.
- The franchise where I trained (in Hornsby, NSW) has had, since I trained, three different franchisees that I know of.
- The [REDACTED] National Sales Manager (at that time I was a franchisee) was recently charged in Victoria with, I believe, extortion (or similar, but a crime committed at [REDACTED] behest). This is exactly the same trick that [REDACTED] tried with me; except that with me [REDACTED] used lawyers to do their dirty work. I also know a number of other franchisees who have been treated similarly. This was an incident that was 'investigated' by the ACCC – who found nothing wrong.
- Because of the action of the liquidators, their lawyers and hangers-on, a disputed debt of \$1,500 has been turned into a debt of (now) more than \$280,000 – which means our family home is being sold from under us.
- After walking away from [REDACTED] I had a mortgage of \$366,000 where we had none before; the repayments are at present closer to \$4,000 per month.
- Add together the mortgage, the monthly instalments (interest only) since then, and the loss we will now sustain through selling the property at a bad time, and the [REDACTED] venture will have cost, without even considering loss of opportunity, in the \$1,000,000 area.
- In the unlikely event that I am now ever able to retire, not that I have any such voluntary intentions, I do not see any way now that I will be able to recover sufficiently to be a self-funded retiree, but will be reliant on the state.

Apart from contact with a few friends I made through franchising, some of whom suffered losses similar to or worse than my own, I have no longer any connection with the subject. I am neither pro nor anti franchising. This submission is made solely in the hope that it may help to create change so that others do not suffer the same fate. Capitalism works best when driven by enlightened self-interest rather

than unfettered greed, as one look at the world today could easily show to anyone with the brains to recognise it. Unfortunately not everyone in business is that intelligent, and it is particularly, or perhaps only, those for whom laws should be written. The [REDACTED] debacle (and a few notable others) was allowed to happen, encouraged even, by poor regulation exacerbated by its non-enforcement.

When I bought the franchise outlet I did not expect a 100% guarantee that it would succeed; although more recent reflection on that subject leads me to believe that with the expert knowledge of the franchisor, those I thought I was contracting with (which is how I saw a franchise agreement), there is no reason I should not have had such an expectation – that is to say, why could not someone who owns, runs, and markets a well established franchise network be genuinely confident of his own product and business acumen? – more especially since I took over an existing outlet. However, whereas I may not have expected a 100% guarantee of success, I also did not expect the reality that, whatever I did, it was 100% guaranteed to fail; and that the longer I stuck it out, the more I would lose.

If you were to compare franchises from two franchise chains that cover a similar market, namely [REDACTED] and [REDACTED], at the time I bought in, and I will not risk antagonising anyone by comparing them too closely – so purely on a cost basis – there would not have been a great deal of difference; obviously depending on location, turnover, etc. Generalising again, today any [REDACTED] would be worth perhaps 3 times what it was then, if there were one for sale; it would be hard to give a [REDACTED] store away, and they would all be for sale. If this situation had developed purely because of differing business tactics it would be one thing – after all one cannot legislate against stupidity – but [REDACTED] was brought to this position because of unchecked illegal practices. Many franchisees knew exactly what was happening and what was wrong, but were powerless to change anything. A very few who were able to challenge through the courts were either bought off (very cheaply, as I heard through the grapevine) and then silenced with confidentiality agreements, or got totally bogged down in an iniquitous legal system until they had no money left.

Whereas [REDACTED], CEO of [REDACTED], and his hired bullies were the direct cause of the problem, they are the only ones who deserve blame.

I mentioned in my previous submissions, Mr [REDACTED], the CEO of [REDACTED], stole \$3,000,000 a year from the advertising fund alone (I mean apart from other scams, not by himself – although perhaps that too), without ever accounting for it. I was by no means the first, nor was I the last, to complain to the ACCC about this and other unconscionable behaviour – in my case trying to extort money from me. The Franchising Code of Conduct, which is crystal clear on the subject of advertising funds particularly, falls under the aegis of the ACCC. Whether it is because the ACCC do not understand franchising, or do not have the staff, or simply do not care I do not know, but they were certainly not doing their job. There was a broad chasm between what we, [REDACTED] franchisees, were told by the ACCC and what I knew even then to be the truth. We were put off with obfuscation, and told months later that [REDACTED] had been investigated thoroughly, that there was one minor infringement of the FCC but that was now remedied (all of which was a complete lie), and that the matter was now closed with none of the franchisees' complaints even being addressed. It is my belief that an **investigation should be made into what the ACCC knew about [REDACTED]** (and probably other franchise chains – [REDACTED] is one that springs to mind, and [REDACTED] another), **when they knew it, who knew it, what recommendations were made, and what was done.** Well, we all know what was done, at least [REDACTED] franchisees and ex-franchisees do.

The FCC has its faults, and has in some ways no more depth than one of those (now thoroughly discredited, I hope) Corporate Mission Statements. For example it contains no suggestions as to penalties for breach of itself (the Code), or the relative severity of various breaches. But on the other hand, since the FCC has never been tested in a court of law, does it really matter? If laws are not enforced it is better that they not be there at all, giving the illusion of protection.

As a last point about the ACCC, had they done their job in the first place I would never have bought a franchise. There is no oversight of franchising at all; in fact, from my meeting with three senior members of the ACCC a few years ago, it was quite clear that they did not have the first idea of what franchising was about. I can say now, quite categorically, that you would be stupid to buy a franchise in Australia, however good it might look at the moment, and whatever its prospects. For one thing, the Master Franchise could be sold and all the due diligence you did is out of the window. The franchisee is the weakest link, is the first to lose, and always loses.

As an aside, there are, to my mind, a number of franchise systems being marketed that should not even exist at all. Not every business concept is appropriate to be made into a franchise. This may be a matter more for common sense on the part of the purchaser, but it is undeniable that a number of unscrupulous people have made a great deal of money by churning unworkable ideas that will last no longer than the buyers' cash.

When I bought a franchise it seemed quite obvious that the better I did, the better the Franchisor did. The more I made, as a percentage of that, the more royalties I paid – a win-win situation. Whereas this is true, it is also true that a Franchisor can make much more if a Franchisee fails, the store is taken over again, and resold (that is, by churning). One might think this to be unconscionable conduct and, as such, proscribed by the FCC, but the ACCC do not seem to think so. Given an infinite number of victims this might appear to be a good plan, but victims numbers are not infinite, there are other considerations, and I think even ██████ might now be able to see that as a long-term plan it has its weak points.

Another problem I see with franchising in Australia is the Franchise Council of Australia, the self-styled peak body. If they are the regulatory mechanism of franchising – I am not sure that is how they see themselves, but if they are – then that mechanism works just as well as any other self-regulatory industry, which is not at

all. In spite of what they claim they do not represent franchisees, only franchisors. They are a powerful lobby whose head is also a major player in a legal firm whose income is in no small amount derived from franchising disputes. Franchising is notoriously weighted in favour of the franchisors, and should ever there be a court case where a franchisee has had even a minor victory, the FCA will fund an appeal until an outcome acceptable to them is reached. The one with the deepest pockets always wins – which obviously is not a problem if you also happen to be the lawyer. In the long run they may do the franchising industry more harm than good.

A document entitled 'Trade Practices Amendment (Fair Trading) Bill 1997, Explanatory Memorandum' has just come to hand; a copy is attached, although I am sure the Inquiry will be well aware of it. It is my understanding that this document foreshadowed the introduction of the FCC itself. From its contents it is quite obvious that all the problems that exist in franchising now existed then – documented in 1997 – and the introduction of the FCC has changed nothing. Eleven years later precisely the same situation still exists. It is my belief that it would be well to accept that it (the FCC) was, as such, a complete failure and advance accordingly; do not waste time cutting off the heads of the Hydra.

As a final word, with regard "whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code"; there must be some subtlety contained in this statement that is beyond my superficial understanding. What sort of agreement is it that someone can make when he has no intention of upholding his side of it? Or is this some sort of technicality that is the legal equivalent of having one's fingers crossed whilst agreeing to something? – which of course the current arrangement allows with impunity.

Signed,
C. J. May

Submission to WA and SA enquiries into franchising.

I bought a [REDACTED] (car care) franchise in June 2003. I have worked in the computer industry for some 40 years, but at that stage I had been unable to find work, and had earned nothing for a year and there were no immediate prospects of that situation changing. I looked at a number of possibilities and decided that having, as I did, no practical knowledge of running a business, a franchise might be the best option. I did have some mechanical knowledge of vehicles, so I was confident with the nature of the [REDACTED] business from that point of view.

After meeting the previous owner of the shop I bought, I called a few other stores to see what I could glean about [REDACTED] generally, but heard nothing to raise any doubts. I received a Disclosure Document (DD) in due course, part of which was the Franchise Agreement (FA) I would be taking over. I was never happy with the FA – it was a very one-sided piece of work, obviously not in my favour. The DD, I have since found, was a masterpiece of fraud and omission – so much so that it was almost complete fiction. The DD requirements then were less onerous than they are today, but it was still grossly deficient. One thing in particular it did not mention, although by no means the worst, was that I would be required to have a direct debit on my account that [REDACTED] could draw on to collect their royalties. A typical abuse of this would be to charge for things and deduct the money, and it would be virtually impossible to recover it. I was certainly not the only franchisee to suffer this.

However, against my better judgment, and probably for lack of other selection, I agreed to buy in. The price was \$175,000 for the shop, plus \$10,000 for stock on hand. I paid 10% deposit on the business, (\$17,500) before I saw the DD, which should never have happened, although I did not know this at the time. I paid [REDACTED] \$6,600 (no paperwork, no receipt) in advance for training. Training consisted mainly of working with another franchisee at his shop for two or three weeks. Whatever my opinion of that, the franchisee in question had won the previous year's [REDACTED] Franchisee of the Year Award, plus a local business community award; as it turned

out he closed his business through insolvency some 4 months later, and that shop has since changed hands at least twice that I know of, as well as being a company store. Such was my training.

From the start a major problem was lack of customers. Many [REDACTED] franchisees were even then starting to complain that the franchise model left no margin of profit for them. That may well have been so, but I was never in a position to find out because I never had enough customers so that my turnover would cover even the rent. In spite of paying 5% of turnover (along with every other franchisee), into an advertising fund, there was little or no advertising done by [REDACTED], who had control of the fund. Enquiries directed at [REDACTED] both from me and others concerning the advertising fund were met with lies, obfuscation, stonewalling, and abuse. Some \$3,000,000 per year simply went missing – unaccounted for – stolen. To them it was simply another income stream. I, together with many others, complained long and hard to the ACCC, but their response was pathetic. They did nothing, and I was treated like some sort of pond-life by them because I was trying to insist on some accountability – something which (in terms of the Franchising Code of Conduct (FCC)) should have happened automatically.

In fact my relationship with [REDACTED] soured on the day I took over. The NSW Sales manager had, it seems, some vendetta against the previous owner which I would also be taking over; or so I surmised. I had not been there three months when I received a Termination Notice (as usual with [REDACTED], late on a Friday afternoon when it is too late to do anything about it before the weekend – standard practice for them). No explanation was given except that I had, apparently, broken the rules. Attempts to find out what this was all about failed, but as an immediate direct result of the stress of this (after all, we stood to lose our whole investment) my wife was hospitalized for a week. I kept things going as best I could, plus trying to look after 3 young school-aged children.

In spite of the termination notice, I was not stopped from trading; if you can call it that. However it did not make for a happy position when I was under the shadow, I thought, of being locked out at any moment. However, eventually, some months later, because of their Termination Notice, I was forced to go to Mediation with [REDACTED]. Note that I had still not been informed of the reason for the termination, despite repeated efforts to find out.

Things became a little clearer at Mediation. It transpired (which I had to work out for myself, and which then [REDACTED] then agreed was the case) that the Termination Notice was based on the complaint of a customer who claimed I had done un invoiced work for him – something that would have been contrary to both my Franchise Agreement, and ATO rules. Had [REDACTED] cared to investigate the complaint at all, which also included a spurious allegation that we had damaged his car (which was not true, but for which I was billed by [REDACTED] anyway) they would have found a copy of the invoice on their computer; it was a requirement that stores transmit copies of their invoices to [REDACTED] HO each day. With the benefit of hindsight, it is now perfectly obvious from everything that happened between that customer, [REDACTED], and me, that the customer had been sent to my store deliberately to entrap me into doing un invoiced work. In fact he failed, but perhaps he did not make that quite clear to [REDACTED]. Everything [REDACTED] did from the time of his complaint was based on what they had expected to happen, rather than what actually transpired. I am aware this sounds like a conspiracy theory, but I did speak to the customer a year or so after I closed, and he as good as admitted it.

After being completely exonerated at mediation where, after establishing the facts [REDACTED] immediately backed down, an agreement was reached that [REDACTED] would lend management assistance – something they should have been doing anyway.

Although it was customers I needed more than management help, apart from the NSW Sales Manager coming to my store and wasting my time for an hour, nothing more came of that. I had previously approached the Assistant Sales Manager, and it was he who later told me that [REDACTED] had instructed him NOT to help me.

Mediation was thus an expensive waste of my time. And so I limped along. In spite of having so few customers that some days I would have no takings at all, I was still working ten hours and more a day to try to keep the place running. A second mediation took place after I stopped paying ██████ – they were, after all, offering me nothing, they stole the advertising fund, there was no other assistance offered, and the ██████ brand name even by then was worth less than nothing*.

*By saying that the ██████ brand name was worth less than nothing, I do not exaggerate. ██████ were, in the years prior to the current owner taking over, quite successful. When 80% of the business was exhaust work, which was quite profitable, the advertising was such that people would think of ██████ when they needed a new exhaust which, before unleaded petrol, catalytic converters, fuel injection, and stainless steel exhaust, was every two years or so. But that all changed, as did ██████ core business which moved more to car servicing. However their very success in the early 1980s and 90s now worked against them because they failed to advertise and let people know that they were no longer only exhaust specialists; if you didn't need an exhaust (and you now do not, or rarely), you didn't go there.

A few days after the second Mediation I eventually walked away from the business, having been there just over a year. I had already consulted lawyers about ██████ treachery, and had been told that it could all be settled within three months at a cost of \$50,000. Although obviously beyond the scope of the enquiry, this is where bad franchising leads, and here is another industry that could use a serious shake-up. After 3 months and \$50,000 the lawyers had not even started. I ran out of patience (and money) with them, and the law suit has dragged on now for 3 years, still no nearer to resolution.

I was never warned by the solicitor who handled the original purchase, and certainly not by the bank through whom the loan was arranged (yet another shark-ridden industry), of the depth of trouble entering into a franchise agreement could provoke.

When I entered into the agreement I was probably unaware of what the FCC was; I had certainly never read it – although I have now. But whether I had or not, I would have expected to exist the sort of protection and remedies that the FCC appears to imply. In fact it is a totally worthless piece of legislation; apart from anything else, no attempt is made by the ACCC to enforce it, or even investigate.

Before [REDACTED], I had no debts and we owned our own house. After the bank foreclosed, we now have an interest-only mortgage of \$366,000 – which costs nearly \$3000 month, so the losses keep accumulating. My wife has been made bankrupt through devious lawyer's tricks, and the liquidator of my company has turned a disputed bill of some \$1,500 – which I did not have at the time – into a bill of some \$150,000.

If you were to look at [REDACTED] nowadays you can see that, after monstrous churning of franchisees (which stood at about 80 shops changing hands even in 2003, although I did not know it and had no way of finding out), the stealing of the advertising fund has taken its toll. From well over 110 stores then there are less than 80 stores left open, many of them company stores, and they are effectively worthless since no-one is making any money; in fact quite the contrary. The remaining franchisees try to negotiate with [REDACTED], but [REDACTED] refuse to even speak to them. It was all totally predictable, and it gives me no pleasure to say I told them so.