

Parliament of Australia

Joint Standing Committee on Corporations and Financial
Services Inquiry into Franchising

Submission of :

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Franchisee, [REDACTED] Wantirna,

September 10th 2008

Summary

My submission is directed at demonstrating the vast imbalance in bargaining power in favour of the franchisor that exists within franchising with particular reference to my experiences with [REDACTED] Inc, its Australian subsidiary [REDACTED] Australia Pty.Ltd. and it's Development Agent for Eastern Victoria and Tasmania. Examples of blatant abuse of that power as it manifests in deceptive and misleading conduct, misrepresentation, bullying and selective application of the Franchise Agreement will be provided. While only limited evidence is attached, evidence in writing is available in support of each allegation made.

Redress is complex and expensive, a fact that is relied upon by [REDACTED]. The ACCC is reluctant to intervene unless there are numerous complainants which is difficult to achieve as [REDACTED] franchisees are afraid of retribution, a fact acknowledged in writing by the Australian Association of [REDACTED] Franchisees. The Franchise Council of Australia charter includes "Members of the Franchise Council have committed to following the mandatory Franchising Code of Conduct, plus any FCA designated member Code of Conduct. This in addition to common law rights, increases protection for franchisees from unscrupulous operators". Despite this unambiguous statement the Council refuses to apply remedies prescribed by it's own rules and contained within it's Complaints Procedure. In fact it refuses to accept or view written evidence in support of a complaint submitted in April 2006. To this day the council has made no decision and refuses to respond to e mails or telephone calls. I suggest that the FCA Board is unwilling to apply it's rules as they are aware that the conduct of [REDACTED] is typical of a number of members. Is there another explanation for a recent change to the Complaints Procedure to exclude complaints such as mine?

Within [REDACTED] owners of more than one store, including Development Agents, are able to transfer revenue and costs between stores or other entities to present the most favourable, albeit false, profit statement when a store is placed on the market. This practice, of which [REDACTED] is well aware, has inflicted both capital and trading losses on many franchisees of whom a number are new immigrants or retirees who have invested their retirement savings in what they believed to be an ethical organisation.

Recommendations

1. That a Tribunal be established similar to the Australian Industrial Relations Commission with the power to conciliate and deliver binding arbitration of franchisee/ franchisor disputes at no cost to the franchisee. This Tribunal should be independent of the ACCC.
2. That Franchise Agreements be precluded from containing provisions which purport to deny the franchisee recourse to protection provided by the Trade Practices Act or class action, rather requiring arbitration with a specified and inadequate maximum sum held in a forum and in a location nominated by the franchisor. The nominated location is designed to inflict maximum financial and practical detriment upon franchisees, excepting in the case of [REDACTED] those resident of Queensland.
3. That Franchise Agreements be precluded from containing provisions that purport to remove the right to legal action against agents or employees of the franchisor. Legal redress should be freely available where agents have engaged in deceptive or misleading conduct or have failed to apply the provisions of the Franchise Agreement when in favour of the franchisee while applying it's terms rigidly against franchisees.
4. That the ACCC be required to apply the deceptive and misleading conduct provisions of the Trade Practices Act more broadly with less reliance upon the unconscionable conduct provisions of the Act which greatly favour the franchisor.
5. That devolving of responsibility to Agents who have a contractual requirement, with associated penalties, to open a specified number of outlets and without due regard for existing franchisees be prohibited. This power should rest with company employees only. There is presently an inherent conflict of interest.
6. That leases be held in the name of the franchisee rather than have them merely named as sub lessee to a head lessee being the franchisor.
7. That a Franchising Ombudsman be created to deal with complaints against franchisors other than those embraced by Recommendation 1.
8. That the Franchise Council of Australia be entitled to represent the views of franchisors only in matters related to the Franchising Code of Conduct.
9. That a requirement for franchisors and franchisees to act in good faith be included in the Franchising Code of Conduct.

Submission

Conduct of [REDACTED]:

- Prior to acquiring the franchise on July 7th 2004 a comprehensive due diligence of all aspects of the business was undertaken. As there was a large shopping centre adjacent to the outlet, and as there were [REDACTED] franchises in most shopping centres I enquired of the [REDACTED] Development Agent as to whether there were plans to open a store within that complex. On both occasions, April 28th and May 26th 2004, statements were made to the effect that there "were no immediate plans". These enquiries are conceded by [REDACTED] as a letter from the Development Agent to the US Site Review Committee that I obtained some twelve months later, despite a requirement that it be furnished on request (see later), stated that "at that time we had not secured a site nor were we in discussions with Centre Management". Evidence is available to refute that assertion. I relied on the statements of the Development Agent as the purchase of a [REDACTED] franchise would not grant exclusive rights to a territory. In any event the Franchise Agreement appeared to provide adequate protection.
- On August 2nd, a mere three weeks later, a letter dated July 27th and incorrectly addressed to the previous franchisees was received from US office stating that it was proposed that a store be opened in the adjacent Knox Shopping Centre. The US office was acting at the request of the same Development Agent who had stated that "there were no immediate plans" to open that store. In that letter I was invited to submit to US any concerns related to the new site and whether I required a review of the proposed franchise and how it would impact our business. The following day I registered an objection and in the alternative requested that I be granted first right of refusal over the proposed site. Implementation of the site review process prescribed by the Operations Manual, which expressly forms part of the Franchise Agreement was also requested. On August 23rd a letter from US was received informing that the lease on the new site had been placed on hold "until a decision had been reached", and the Development Agent would commence the Site Review process which would include conducting customer surveys and preparing an Opinion Letter to enable the US based Site Review Committee to make a decision on whether the franchise should proceed and, if so, to whom it should be awarded. The Opinion Letter was to be based on data obtained during the surveys. Also contained was an invitation to submit further material as soon as possible and a statement that I was "entitled to see a copy of the Opinion Letter" so that appropriate submissions could be made in the Site Review process.
- On August 24th US office and the Development Agent were advised in writing that I would be making a further submission and to assist copies of the survey data and Opinion Letter, to which I had an entitlement, were requested. Later that day I was advised by the Development Agent's wife (General Manager) that the time for objections had passed

- and the data and Opinion Letter had already been forwarded to [REDACTED] US and that a decision was pending. An objection was immediately lodged noting that no response had been received to my request for first right of refusal over the new franchise on which work had commenced (the lease had supposedly been placed "on hold") in breach of the Franchise Agreement. No response was forthcoming.
- On October 7th an e mail was sent to the Development Agent again registering concern at having been denied the opportunity of making a further submission despite there being a clear entitlement, noting that a sign [REDACTED] store opening soon" had been erected despite being informed in early to mid August that no work was currently being performed (as required by the Franchise Agreement), requesting advice on the status of my application for the franchise and again requesting survey data and the Opinion Letter that had been submitted by the Development Agent to the US in support of the application by an existing multi store owner for the Knox franchise.
 - Shortly after the Development Agent informed that I had not been awarded the franchise as I "had not found the site", which is not a justification provided by the Franchise Agreement as the decision is the province of the US based Site Review Committee (see later), that it was [REDACTED] policy that I be denied the information requested (contradicts Franchise Agreement) and stating that to his knowledge no work was being performed on the site. This was despite the appearance of a [REDACTED] sign on the site that could only have been erected with his authority or knowledge. He further stated that he could provide me with a copy of the Site Survey data and maps only. This ignored the August 23rd invitation from US office, the Franchise Agreement and a written statement from the US based Ombudsman that the "Development Agent office should forward to you prior to it (the Opinion Letter) arriving here at HQ". He further stated, correctly, that the onus was on US office to inform of the outcome of a Site Review and apologised that no such advice had been received.
 - There was no response from US office to further requests for information regarding my objection and application until a letter was received on December 2nd being the day following opening of the new outlet. That letter from the Site Review Administrator said "The Site Review ... has been completed. The Site Review Committee carefully reviewed all of the information submitted and has decided to move forward with the proposed location". The letter did not mention whether I had been awarded or denied the franchise nor to whom it had been awarded. There was also no mention of the fact that the Site Review Committee had previously awarded me first right of refusal, of which I became aware some nine months later.
 - During December 2004, after the new store had opened, my wife and I were given the survey data, and not the Opinion Letter by the Development Agent's office. The Opinion Letter was denied on the grounds that "it contained confidential business information related to the (successful) franchisee". This statement was later found to be untrue. The survey material contradicted earlier assertions that the data showed the new store "would have little to no impact on your

customer base” and in fact illustrated a potential loss of in excess of 20% of our sales. This was despite the intentionally restrictive nature of the questions asked into which the franchisee has no input. Immediately the store opened sales fell by some 15% thereby reversing the trend of above average sales growth that had been achieved in the five months since our acquisition of the store. Sales deteriorated further over the next two years. The new store immediately achieved sales of around \$30000 per week a significant part of that being drawn from our former customers for whom it was more conveniently situated.

- Following numerous requests of the US based Ombudsman necessitated by the ongoing refusal of the Development Agent to provide it, a copy of the Development Agent Opinion Letter was eventually received from her office on August 19th 2005 one year after it was initially requested and after the Knox franchise had been open for almost nine months. The Opinion Letter signed by the Development Agent and his General Manager wife had concluded contrary to survey data that the opening of the new franchise would have little or no effect on the existing franchise, in fact sales may increase which was contrary to prior experiences, and that I should not be offered the franchise. There were also numerous other examples of blatant misrepresentation of data, significant errors and omission of relevant facts, which could not be accidental given the experience of it's authors and signatories in collecting data and writing Opinion Letters.
- On September 10th 2005 I discovered that the Site Review Committee had decided contrary to the recommendation of the Development Agent in the Opinion Letter that the Knox franchise should proceed however I should be offered first right of refusal. Following further investigation as to why I had neither been granted nor advised of the award of first right of refusal advice was received from Site Review Manager [REDACTED] the appropriate US based officer, via e mail (attached) that “the Development Agent however disagreed with the decision and appealed it through [REDACTED] (Ombudsman) in the Executive Office”. He further explained that “he could not clarify the rationale for the decision as his department was not involved and that an explanation should be sought from [REDACTED]”. She had previously advised Mr. [REDACTED] that the “company has made a clear decision to move forward with the site no matter the discrepancies at this point” (attached).
- An explanation was then sought from the Ombudsman as to why I was not made aware of the initial decision, was not informed that an appeal process existed, that it had been enacted without my knowledge and that I had not been given the opportunity of making a submission. The Ombudsman replied that “it was not actually an appeal” (no appeal process is available within the Franchise Agreement) then sought to invoke the Franchise Agreement as justification. No response was received to numerous requests of her to specify the clause/s on which she had relied. I am aware of two previous instances in which the Site Review Committee rejected the recommendation of a Development Agent and awarded the franchise to an objector. The Ombudsman did

not intervene. In both examples the objecting franchisee had some years of experience within the system compared to my three weeks and thus could not be treated with the same contempt.

Development Agent's Motive

- Evidence suggests that a deal had already been done to award the franchise prior to the Opinion Letter being prepared which meant that I could not be awarded first right of refusal. There is no other plausible explanation for being denied entitlements clearly bestowed by the Franchise Agreement nor being denied the right to view the Opinion Letter until twelve months later. Further the successful applicant informed me at a meeting on August 2nd 2004, ie the day that notice of intention to set up the new franchise was received from ██████████ that he had been awarded the franchise and that a lease "would be signed next week and the store would open in September". Such was the haste that the Opinion Letter even included data that was taken after it had been forwarded to US office. The store was placed on the market immediately it opened at a price that would produce a capital gain of some \$350000 to \$400000. The successful applicant was a multi store owner who had been granted a franchise in another major shopping centre despite an objection from a nearby franchisee whose business would obviously have been, and in fact was, severely affected.

Bullying and Harassment:

- On March 3rd 2005 I was offered \$10000 in advertising assistance to offset the effect of the new store on our sales. That assistance was stated by the Development Agent to be conditional only on approval by US office. It was subsequently learned that conditions attached to the type of advertising to which the funds could be applied. I withdrew from the agreement as the advertising excluded was that to which the funds were to be applied. The funds were offered under duress as I was not made aware of the effect of the agreement at the time of signing and to this day have received no advice apart from legal threats from US office that my application had been successful.
- At a meeting with the Development Agent and his wife (General Manager) on June 14th 2005 in which my wife and I raised concerns regarding the conduct of ██████████ and the possibility of instituting legal action Mrs. ██████████ responded with words to the effect " you won't be taking us on you will be taking on the whole of ██████████".
- On June 15th 2006 solicitors acting for ██████████ delivered a Notice of Termination of the Franchise Agreement unless outstanding royalties and advertising levy were paid within thirty days. ██████████ and the Development Agent had previously been advised that cash flow of the business could not sustain direct debit of the amounts weekly. The Franchise Agreement prescribes a procedure to be observed in cases where franchisees cannot make such payments. Legal action is to be

implemented as a last resort. [REDACTED] Australia and US were asked for an explanation as to why these processes had been ignored. Both the US Corporate Attorney and Australian Corporate Counsel replied that the Operations Manual "was only a guide and could not cover every possible scenario". This is despite the fact that the Operations Manual expressly forms part of the Franchise Agreement, specifically includes a procedure embracing non payment of advertising levy and royalties and is applied rigidly against franchisees even for the most minor deviation. I have evidence that a number of other franchisees were not terminated despite being in arrears for periods and amounts far in excess of that applicable in my case. It should be noted that a standard document exists to cover repayment of arrears over an agreed period when a Termination Notice has been issued. Why was I not offered this and why were the processes above ignored?

- [REDACTED] previously withheld a rebate that was due and had been paid to other franchisees. Reasons given by the Development Agent were ridiculous including questioning whether the required waiver form had been completed, having over 200 to process, change of co-ordinator and finally that the waivers had been processed incorrectly. The only plausible explanation is that this was punishment for questioning the conduct of the Development Agent and [REDACTED]. The rebate was paid almost immediately a hold was placed on direct debit of royalties and levies due to [REDACTED]. The Queensland based Legal Administrator described the reasons given as "ridiculous". No Notice of Termination was served in this instance. When I proposed a repayment programme [REDACTED] insisted that I sign an agreement that included that I "release [REDACTED] Pty. Ltd. And it's agents or employees from any claim I have or may have against them as of this date". Of course I refused, the sum was repaid according to schedule and there was no further discussion of this demand.
- A Notice of Termination was recently received giving sixty days to remodel the store at a cost of approximately \$50000 - \$60000, funds that the business does not have as a direct consequence of the actions of [REDACTED] in opening the new outlet and at the same time denying me the franchise. In their haste to deliver the notice [REDACTED] relied on an incorrect clause and took in excess of two months from my informing them of the error to acknowledge their mistake. Of course another Notice of Termination was immediately substituted. They refuse to accept that remodelling is not required until May 23rd 2009 under the terms of the Franchise Agreement as this is the means by which [REDACTED] believe that the business may be taken from me without any or adequate compensation. It would of course be quickly re-sold, probably to a member of "the club", with [REDACTED] and the Development Agent receiving a substantial profit. This means of deriving quick profits is becoming common. Generally the franchisee has been out of compliance for a long period, in some cases over two years. Why have I not been afforded the same consideration? The current notice purports to take effect on November 7th 2008.
- A written statement by the National Chairman of the Australian Association of [REDACTED] Franchisees reflects the extent of the

intimidation and selective application of the Franchise Agreement in which ██████ engages. He stated "Your perceptions of ██████ Systems Australia, Development Agents and their representatives applying the Franchise Agreement when it suits them may well be true in some cases. You are not the first franchisee who has found this. ██████ can only act when a case is submitted to us. Unfortunately, franchisees back off giving us this information in fear of retribution by their accused". A number of franchisees have contacted me regarding the conduct of ██████ however most are reluctant to "go on the record" for fear of the inevitable punishment. I believe that the problem is not restricted to ██████

Contempt for the Franchisee

- This may best be demonstrated by the recent instance of a franchisee who paid \$465000 in 2003 for a franchise in a major Melbourne shopping centre. In January 2007 he was informed by centre management that the food court in which he was located would close and that he would be temporarily relocated from March 28th 2007 pending return upon completion of a refurbished food court. As he had heard nothing from ██████, being the Head Lessee, on March 29th 2008 he contacted the Development Agent's General Manager and the National Leasing Manager for ██████ Australia regarding the lease upon a new location. He was eventually informed by ██████ Australia "that it will be no problem getting a site and I will get back to you". A number of calls were made to no avail until he was informed on April 11th 2008 by the Development Agent's General Manager that no site was available. He learned later that day from centre management that no application had been received from ██████ or it's agent until March 29th 2008 which happened to be the day upon which he raised his concerns with ██████. Numerous phone calls to both ██████ and the Development Agent were not returned however it was learned on May 15th 2008 that ██████ Australia had contacted ██████ and been told that no application had been received from ██████ within the required time span and all sites had been leased. His investment was immediately rendered worthless excepting for the value of any equipment that he could remove.

He was subsequently offered by the Development Agent a site in a small strip shopping centre approximately one kilometre from the major centre in which he had been located. The incentive was that the landlord would contribute \$50000 to the cost of fit out and give three months free of rent. While still considering the location the franchisee received a call from the Development Agent informing him that "the \$50000 was off as the owner had decide to renovate himself but three months rent free stood and he had three hours to decide or it would be given to another franchisee". The offer was rejected. It is understood that the Development Agent has leased the site, almost certainly availed himself of the \$50000, fitted the store out very cheaply, may create a sales record using techniques available to multistore owners and Development Agents and sell shortly thereafter at a substantial

profit. The distinct possibility exists that the Development Agent may subsequently acquire a site within ██████████ Doncaster, open a franchise without regard to the proper processes and promptly resell at a massive profit. Should the store referred to above be sold by the Development Agent, which is almost certain, the new franchisee would immediately suffer from plummeting revenue

Deceptive practices of multi store owners

- Multi store owners, including Development Agents, have the capacity to allocate both revenue and costs to a particular store or to apply other methods of artificially increasing revenue. This is applied over a period leading up to the store being placed on the market to give a false picture of either or both revenue and cost with the objective being to achieve a higher sale price. Immediately the new franchisee acquires the store sales fall and in some cases costs escalate to the point that the business is not viable. Capital values also diminish. A practice in which some multi store owners are engaged is to charge labour to a corporate entity rather than the shop being sold. The unsuspecting buyer again is deceived.

Again most but not all affected franchisees are reluctant to speak of their experiences. However in one instance a franchisee purchased on the basis of revenue of some \$8500 per week to discover immediately after acquisition that revenue fell to around \$5000 per week while costs increased.

The Development Agent produces monthly a newsletter in which all stores are ranked according to sales revenue. It is commonplace to find a store achieve significantly higher sales, thus ranking, at or around the point that it is placed on the market only to fall or plummet shortly after sale. This may indicate that the previous owners were very capable and the new incapable or almost inevitably it may reflect other factors.

The Franchise Council of Australia.

- The charter of the Council includes a commitment from members to the Franchising Code of Conduct and FCA member standards. Membership “increases protection for franchisees from unscrupulous operators” and “intending franchisees should only deal with members of the FCA”.
- In October 2005 the FCA changed it’s constitution to allow for a complaints process against members “to ensure that the market has confidence in dealing with FCA members and that members maintain high standards within their dealings”.
- When the complaint was lodged in April 2006 the rules stated “If a member is in breach of the Member Standards then action will be taken against the member. This action may result in directing the member to resolve the matter with the complainant in favour of the complainant or more serious action such as suspension or termination of membership”. As required by FCA a proposed resolution was tendered

as were the member standards allegedly breached. At that time there was no mention of matters that were proscribed.

- In April 2006 I lodged a complaint against [REDACTED]. That complaint was lodged in the format prescribed by the rules applicable at that time. There was no response to requests of then CEO [REDACTED] for information on the status of my complaint until he stated on July 11th that "we are advised by the member that the matter is before the courts and we will consider this information when determining our response to the complaint". I had predicted that [REDACTED] would so respond and assured him that was not the case. It could easily have been checked. Following further enquiries he stated on August 18th that a "watching brief" would be adopted until mediation and court action had been completed. He was aware that mediation had been completed in December 2005 and that no court action had been commenced. He failed to respond to further enquiries. Following his hasty departure I contacted Acting CEO [REDACTED] on December 5th 2007 who stated that "reliance on legal proceedings was "not an option that was available". On checking electronic and hard copy files he could find only the letter of complaint and no history of contact with Mr. [REDACTED] whom he stated had left "leaving only one large coat". He asked that I send all relevant material which was done on December 10th. Again silence prevailed. When contacted on January 25th 2008 he demanded that I sign a complaint form that did not exist when the complaint was originally lodged. I refused and suggested that the complaint should be handled in accordance with the procedures applicable when it was lodged. On April 2nd the matter was raised in a meeting with new CEO [REDACTED] attended by Chris Pearce MP and Heidi Victoria MLA and myself during which he requested that copies of all related material be forwarded to him following which the matter "would be taken to the Ethics Committee for prompt determination". The first response was five weeks later when again it was demanded that I sign the new complaints form which was done on June 2nd following an assurance that in so doing no rights were waived. On June 13th permission was sought by FCA to forward the complaint to [REDACTED]. Not only had FCA received a more detailed complaint in April 2006, point 4 of the complaint form that I had signed expressly gave this authority. Numerous enquiries of Mr. [REDACTED] have elicited no reply nor return calls excepting a statement on August 5th "that the matter was being progressed internally and with [REDACTED]". He asked for and immediately received an unequivocal assurance from me that the matter was not before the courts as alleged by [REDACTED]. Neither Chris Pearce nor Heidi Victoria have received any reply to their various enquiries. Requests by myself and the MP's to present written evidence to the Council have been ignored. How can any matter be determined without all evidence being reviewed? I suggest that conduct such as that engaged in by [REDACTED] is common due to the imbalance of power in the franchising industry and for that reason the FCA will not accept evidence that clearly indicates breach of rules and demands censure of a member.

- The FCA purports to represent franchisors and 72000 franchisees. Late in 2007 Mr. [REDACTED] was appointed a Director and Chairman of the National Franchisee Forum. This was obviously intended to overcome the charge that the FCA was merely a franchisor body. Given their stance in Ketchell's case even after the appointment of Mr. [REDACTED] it appears that nothing has changed. On August 4th 2008 I enquired of Mr. [REDACTED] whether he was aware of my complaint and whether he advocated for franchisees. He appeared to have no knowledge which Mr. [REDACTED] wrote on August 5th was because the matter had not been raised with Directors. [REDACTED] has divested himself of all [REDACTED] franchises except one. He was, at the point of our conversation, boarding an aircraft with his business partner bound for Cuba to further his venture as a franchisor. Even if informed of complaints, which appears not to occur, how could he legitimately represent the interests of franchisees as he is apparently pursuing his own business and FCA agenda?
- Some time after the meeting with the CEO the rules of the Council as they apply to complaints were changed to specifically exclude claims such as mine. Again the FCA has shown itself to be a franchisor body that has no genuine interest in maintaining or enhancing standards within franchising and certainly has no intention of ensuring member compliance with those standards. It is imperative that an external Government body or bodies be established to set and enforce standards and determine franchisor/franchisee disputes and other complaints against franchisors.
- As of this date communication with the Chair of the Council, Chair of the Ethics Committee and Chair of the Franchisee Forum have elicited reply only from the Chair of the Ethics Committee who typically ignored the questions asked stating once again that an explanation had been sought from [REDACTED] again attempted to pass the matter elsewhere and of course continued the denial, stalling and refusal to act within it's own rules which has become a hallmark of this organisation.

[REDACTED] then Regional Director of [REDACTED] is quoted in Business Review Weekly of January 20 2005 as saying "My biggest concern is maintaining trust in the concept of franchising by ensuring the good operators continue and the bad look elsewhere". The demonstrated behaviour of her organisation and of the Franchise Council of Australia do little to further that objective.