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The Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Department of the Senate  
PO Box 6100 Parliament House  
Canberra  
[Corporations.joint@aph.gov.au](mailto:Corporations.joint@aph.gov.au)

Dear Secretary,

#### **SUBMISSION TO INQUIRY INTO THE FRANCHISING CODE OF CONDUCT.**

Thank you for the invitation to make a submission to the inquiry.

The Committee is to inquire and report on the operation of the Franchising Code of Conduct; and to identify, where justified, improvements to the Code, with particular reference to:

1. The nature of the franchising industry, including the rights of both
2. Whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code, having regard to its presence as an element in paragraph 51AC (4)(k) of the *Trade Practices Act 1974 (Cth)*?
3. Interaction between the Code, Part IVA and Part V Division 1 TPA, especially with regard to the obligations in s 51AC.
4. Operation of the dispute resolution provisions under Part 4 of the Code.
5. Any other related matters.

#### **MY BACKGROUND**

My name is Jenny Buchan. My relevant background is:

- First career - commercial lawyer in private practice in New Zealand, Melbourne and Sydney

- 6 Months at the Office of the Mediation Adviser assisting with its establishment.
- 2000 – 2001. Trade Practices Act compliance planning and implementation as a consultant to large companies
- Second career, since 2002 - lecturer in business law at the Australian School of Business, UNSW. My list of research publications, accessible via the link below, demonstrates my commitment to empirically testing the numerous assumptions underpinning the legal aspects of franchise networks.  
[http://www.blf.unsw.edu.au/nps/servlet/portalservice?GI\\_ID=System.LoggedOutInheritableArea&maxWnd= Staff AcademicStaff JennyBuchan Publications](http://www.blf.unsw.edu.au/nps/servlet/portalservice?GI_ID=System.LoggedOutInheritableArea&maxWnd= Staff AcademicStaff JennyBuchan Publications)

Since 2002 I have conducted research on:

- Comparing franchisees to employees,
- Ownership of intellectual property in the franchise network<sup>1</sup>,
- Retail leasing patterns in franchise networks,
- Effectiveness of s 51AC *Trade Practices Act 1974* (Cth) and
- The impact of franchisor failure on franchisees<sup>2</sup>

I am a PhD candidate at the Law School of Queensland University of Technology, researching the law relating to franchisor failure.

## MY SUBMISSION

### **Nature of the industry and rights of both parties.**

First, to clarify, franchising is not an industry itself. It is a business method that is successfully used within numerous industries.

The franchisees' decision to purchase a franchise is based on many subjective factors, and on the information found in the Disclosure Document that complies with the Franchising Code of Conduct (the Code). Once the franchisee has signed a franchise agreement, its rights are contained in that contract and other contracts they sign.

Individuals always act to protect their own best interests. Franchisors, being the stronger party, always draft the franchise contract. Standardization is the norm with such contracts. Franchisees are encouraged to read the franchise agreement and to ask questions. Usually any requests by an incoming franchisee for changes to the network's standard franchise agreement

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<sup>1</sup> *Franchisor' Registered Trade Marks – empirical surprises*. Intellectual Property Law Bulletin, September, 2008 (in press)

<sup>2</sup> *When the franchisor fails* can be accessed at [https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-B0A8FE10/cpa/hs.xsl/726\\_17547\\_ENA\\_HTML.htm](https://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-B0A8FE10/cpa/hs.xsl/726_17547_ENA_HTML.htm).

are strenuously opposed by the franchisor. The franchisor has a legitimate interest in wanting to keep all franchise agreements standard from an administration point of view.

Unless the franchisee or its adviser has extensive experience in franchising, the questions they ask about the franchise agreement will be framed by what is in the draft agreement. Things which should be covered are not going to be on the adviser's radar unless they are either in the document, or within the adviser's experience. For example, there is no incentive for franchisors to make reference to their own potential administration or insolvency in the franchise agreement. It is almost never a contract term. By contrast, franchise agreements always provide rights for the franchisor in the event of the franchisee's death, incapacity, bankruptcy administration or insolvency.

Franchise agreements last from one year to an indefinite term. Just as we negotiate and re-negotiate the terms of a marriage as children are born, career opportunities arise or are lost, health changes, so the franchisor/ franchisee relationship that is of long duration has the need to be refashioned periodically. However, once the franchise agreement is signed, power and control reside with the franchisor. In a poorly run franchise network, the children are never allowed to grow up. The price of growing up and asserting oneself is the risk of being cast out of the family.

Franchisees use the words 'I was breached' to mean that the franchisor set up a situation whereby the franchise agreement was breached, then used this as a reason to justify terminating the franchise agreement or buying back the franchised business for a smaller sum of money than a franchisee would expect to get for it on the open market.

### **Nature of the industry?**

The franchise model is used in an ever wider range of situations. Risk may be shifted from franchisor to franchisee and return from franchisee to franchisor in numerous ways.

The leasing patterns identified where franchisors have franchisees conducting their business from retail premises help to demonstrate the diversity and complexity that exists within the franchise model.

There are at least 12 different ways a franchisor, landlord and franchisee can be linked to retail premises.

Model 1: The franchisor owns the premises and leases them to the franchisee;

Model 2: A legal entity related to the franchisor owns the premises and leases them to the franchisee;

Model 3: The franchisor leases the premises from a landlord and sub leases them to the franchisee;

Model 4: A legal entity related to the franchisor leases the premises from a landlord and sub leases them to the franchisee;

Model 5: The franchisor leases the premises from a landlord and grants a license to occupy them to the franchisee;

Model 6: A legal entity related to the franchisor leases the premises from a landlord and licenses them to the franchisee

Model 7: A master franchisee leases the premises from a landlord and sub leases them to the franchisee;

Model 8: A legal entity related to a master franchisee leases the premises from a landlord and sub leases them to the franchisee;

Model 9: A master franchisee leases the premises from a landlord and grants a license to occupy them to the franchisee;

Model 10: The franchisee leases the premises direct from the landlord;

Model 11: The franchisee owns the premises;

Model 12: There are no formal occupancy arrangements.

Each model has slightly different legal ramifications that only become clear on the occurrence of various events. The crystallizing events may be, for example:

- Termination of the franchise agreement
- Default under the lease. For example, Kleins (now in administration) held the head leases of all franchisees stores. The franchisees occupied their stores under Model 6 above. Kleins collected the rent from the franchisees and paid it to the landlords. When Kleins fell into financial hard times not all of the rent was forwarded by Kleins to the landlords on time and some franchisees found themselves threatened with eviction from their premises. See: <http://www.ferrierhodgson.com.au/caseprofiles/details.cfm?objectID=57>, [http://www.ferrierhodgson.com/content/newsletter/archive/2/ffocus\\_june\\_08.pdf](http://www.ferrierhodgson.com/content/newsletter/archive/2/ffocus_june_08.pdf)
- Termination of the lease
- Refurbishment of the shopping centre
- Accidental destruction of the premises

- Demolition clauses in leases
- Franchisor's decision that the franchisee should relocate from a shop to a kiosk
- Administration of the franchisor or franchisee
- Insolvency of the franchisor or franchisee
- Compulsory acquisition of the land triggering payment of compensation to some but not all parties. (e.g. *Jax Franchising Systems Pty Limited v State Rail Authority (New South Wales)*; *Jax Tyres Pty Limited v State Rail Authority (New South Wales)* [2003] NSWLEC 397 <http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/nsw/NSWLEC/2003/397.html?query=^Jax%20tyres>)

It is theoretically possible to make provision for some of these events in the original franchise agreement. There is no incentive for the franchisor, however, to admit that its business might go into administration, and therefore no incentive for it to provide for the franchisees rights in the franchisors administration.

There is anecdotal evidence that if a landlord is not prepared to agree to fully compensate a franchisor if a demolition clause is implemented, the franchisor that would usually operate via Model 3 will 'let' the franchisee operate via Model 10 and thereby take all risk of the consequences if the demolition clause is invoked. If there was a national, free, register of franchise disclosure documents and franchise agreements, the franchisee's advisers would be able to work out that this is not the usual *modus operandi* for the particular franchisor and could ask some useful questions. Currently, all the franchise adviser has to inform them is the specific (as it turns out in that case, atypical for the network) disclosure and the version of the agreement that their client will sign.

**Should an obligation for franchisors, franchisees and prospective franchisees to act in good faith be explicitly incorporated into the Code, having regard to its presence as an element in paragraph 51AC (4)(k) of the *Trade Practices Act 1974* (Cth)?**

In short, yes, it should be incorporated into all relational commercial contracts. In this regard I do not think franchise contracts are different to other relational contracts.

Dr Bill Dixon, <http://www.law.qut.edu.au/staff/lstaff/bdixon.jsp> a senior lecturer at QUT Law School is Australia's leading academic authority on good faith in commercial contracts. He has thought and written extensively on the subject and his informed views would add more to the inquiry in this area than I could.

That said, s 51AC (3) (k) and 51AC (4) (k) TPA state that one of the things a court may consider in trying to work out whether conduct is unconscionable is the absence or presence of 'good faith'.

This is not the same as imposing a mandatory requirement that business relationships that fall under 51AC must be entered into, conducted or prematurely terminated with good faith by all parties. Good faith is, thus, not already covered. There are numerous examples in the franchise sector of the absence of good faith in a transaction, and the resulting detriment to one of the parties. For an example of conduct the franchisee alleged was not in good faith, *Meridian Retail v Australian Unity Retail Network* <http://www.austlii.edu.au/au/cases/vic/VSC/2006/223.html>

The legislature should consider whether it would be more appropriate to insert a good faith requirement into all consumer contracts under Part V Div 2 TPA than to leave it as an option under s 51AC. The benefit of this would be that the parties could not contract out of it (ref to Dixon). If a requirement of good faith is inserted into the Code the risk is that, by deduction, good faith is not required in other consumer contracts as it is franchise contracts that have been singled out for imposing the obligation.

**Interaction between the Code, Part IVA and Part V Division 1 TPA, especially with regard to the obligations in s 51AC.**

Part V Division 1 relates to pre contractual events.

Part IVA is capable of addressing events that occur after a contract is entered into.

Both Parts of the TPA fill necessary, and separate, roles.

In my opinion section 51AC should be tested in the High Court before it is amended. The ACCC should join an action that looks as if it 'has legs' so they do not have to do all the running.

The ACCC should be encouraged to resist the temptation to settle clear cut situations of unconscionable conduct (by having the recalcitrant party sign a s 83A undertaking), and instead it should pursue the matter through to judgment. That is the only way the law will be tested.

**Operation of the dispute resolution provisions under Part 4 of the Code.**

Currently the Code requires parties to a franchise agreement to attend mediation if a mediator is appointed. Several issues are worth considering:

The Code states that (clause 27) "A party to a franchise agreement who has a dispute with another party to the franchise agreement may start the procedure under clause 29." Given the

range of models franchisors use I would recommend extending the people who have mediation available via the OMA to master franchisee. Sometimes they have a direct contractual relationship with the franchisee and sometimes they do not, depending on how the franchise is structured. The franchisor should have a right to participate in this mediation. This would recognise that sometimes (as in Greenacres in NZ) a master franchisee is the problem, the franchisor leaves it to the master to sort out problems with franchisees in its territories, but there is no contractual relationship between franchisee and master, and no right to initiate mediation.

The Code states: "The parties must attend the mediation and try to resolve the dispute". There is anecdotal evidence that some parties refuse to attend mediation. The OMA could quantify this. There appears to be no follow-up by the ACCC of parties who refuse to attend mediation. I suggest that the OMA be asked to supply a list of parties who refuse to attend mediation – say every 3 or 6 months, to the ACCC. I suggest the ACCC be required to post the list on its website in a 'name and shame' exercise. The identity of both the party and the relevant franchise network should appear on the list. This may help advisers alert their clients to avoid purchasing a franchise from a franchisor that refuses to adhere to the Code.

Whilst Professor Pengilley's submissions about the importance of the confidentiality of the mediation process are valid, the other side of the coin is that there are currently no useful statistics available about the true nature of disputes, serial offenders (if any), the speed and cost of the process, etc. I submit that the OMA could release sanitized statistics that are far richer than the bland numbers currently available without compromising the mediation process.

#### **Any other matters.**

Two other matters:

Free public access: All franchise networks standard franchise disclosure and franchise agreements should be posted on a freely accessible, up to date, website. Two such repositories now exist in the USA so it can be done. This would help:

- Researchers, and
- Most importantly, it would help individual franchisee's advisers. These people may be based in a remote town (e.g. Alice Springs Roma, Derby, Broken Hill) where there are not many franchisees and so not a great depth of experience at advising on them. They may be a suburban practitioner (lawyer or accountant) who has never acted for a franchisee before. Currently, they have no way to benchmark the set of documents that

sits on their desk from the normal set for that network and the norms of the sector (e.g. other fast food franchises).

The data in Appendix 1 is replete with question marks. Each question mark represents data that could not be discovered from extensive searching on public databases. Truly robust research can not be done without access to accurate data.

Franchisor failure: The Code should include a requirement that franchisors disclose the specific consequential contractual risk to the individual franchisee of the franchisor being placed into administration or becoming insolvent (failing). (See Matthews Report Recommendations 3 and 21) This should not be left to the ACCC to do generically. This is because:

- The impact on a franchisee of its franchisor failing is profound.
- Each franchisee within a network may be exposed to different risks because of the way their consequential lease arrangements are structured, etc.
- The franchisor's failure is usually not the franchisee's fault.
- Franchise agreements provide for the death/disability of the franchisee's directors and the administration /insolvency of the franchisee but not for the more devastating event for the franchise network, the failure of the franchisor.

It is time for the sector to be realistic about franchisor failure. Because the power in the drafting and negotiation sits with the franchisor, it is almost impossible for an otherwise keen franchisee to insulate themselves from the consequences of franchisor failure ex ante. The 12 urban myths about franchisor failure are:

1. **Franchisors only franchise a tested and successful business.** Not always true. Refer to Appendix 1
2. **Hardly any franchisors go into administration or become insolvent.** See Appendix 1. This is a small sample of the failed franchisor in Australia because, my research has revealed, they are very difficult to identify from the public record and many sink without trace. I identified the franchisors in Appendix 1 by collecting data from the media and occasional court cases. It should be noted that;
  - a. In some instances the court cases did not enable me to identify the identity of the franchise network. For example in *Rousellis v Maiurano* [1998] NSWCA 196 Fitzgerald AJA referred to the franchise agreement as being between the appellant and the franchisor that was described as 'two companies, which at the time were insolvent and were later ordered to be wound up on that ground' without naming the companies or the trading name of the franchise network. The respondent was a director of the companies.



- b. I interviewed several liquidators who cited privacy/ client confidentiality as the reason for not being prepared to add to the list in Appendix 1.
  - c. Griffith University conducts the biannual franchising Australia survey. The Griffith database records the former franchisors that are no longer contactable two years later but this is not a matter of public record.
  - d. Not all of the uncontactable franchisors on the Griffith database have failed; some (for example Ikea and ShopFast) test the franchise model and decide it is not for them.
  - e. Jason Gehrke writes that his analysis of "...the advertiser list of a 1996 edition of *Franchising Magazine* indicated that of 113 franchisors then advertising for franchisees, 34 could no longer be found to exist just 10 years later – an attrition rate of 30%. ..." <sup>3</sup>
  - f. Perrigot and Cliquet <sup>4</sup> studied 952 franchising networks in France during the period 1992-2002, and found that only 42.13% survived.
3. **Franchisees underperforming and forcing the franchisor into litigation are the reasons franchisors fail.** Not true. Of the franchise systems that have become insolvent in Australia the reasons for failure are varied. It is not always possible to work out from the public record what the underlying cause of the insolvency was.
- a. Some (for example Cut Price Deli) may attribute their failure to franchisee litigation but in the CPD case the franchisees litigated successfully in the Federal Court in Queensland - the franchisor was engaged in fundamentally poor business practices.
  - b. Canadian insolvency litigator Craig R. Coltraine<sup>5</sup> states: "Poor financial performance, including the accumulation of significant debt when the franchise system is not expanding, growing operating losses, the writing down of assets and re-financings are obvious indications that a franchise is in difficulty. ... Identifying financial problems in non-publicly traded corporations is more difficult."
  - c. Kleins appears to have failed because they had opted for an unusual franchising model that was not sustainable as the sector of the market they were in encountered competition from market stalls and internet based retailers.
  - d. The Franchising Task Force Report of December 1991 in Australia noted the reasons for franchisor failure as:
    - Under capitalization of the franchisor

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<sup>3</sup> When Franchisors fail.17 June 2008 <http://www.smartcompany.com.au/Blog/Jason-Gehrke/20080617-When-franchisors-fail.html> ,viewed 11 August 2008.

<sup>4</sup> Survival of Franchising Networks in France from 1992 to 2002 (**abstract**) ISoF conference 2004 Rozenn Perrigot, Gérard Cliquet

<sup>5</sup> Birenbaum, Steinberg, Landau, Savin & Coltraine LLP, Toronto, Canada; Unpublished conference paper *Franchises: Insolvency and restructuring* June 2002, p3

- Too rapid expansion of the franchise system
  - Poor product or service
  - Poor franchisee selection
  - Franchisor greed
  - External factors
  - Devaluation of the Australian dollar
  - An increase of import duties
  - The withdrawal of an important source of products
  - An aggressive and cheaper competitor
  - Severe downturn in the economy
  - The withdrawal of supply of critical product
  - Fraud and/or greed on the part of the Franchisor”
- e. For a financially troubled business, insolvency may be part of a considered business strategy. (ie strategic insolvency) It provides;
- ‘...an opportunity ... to solve operational or financial problems and emerge as a more viable company. Bankruptcy (the terms for both personal and corporate insolvency in the US) provides a useful business tool for a company to reorganize its operations, deleverage its balance sheet, accomplish a sale of assets, obtain new financing or improve its capital structure. For example, bankruptcy may assist a franchisor in addressing the following challenging business issues; overexpansion in the market and the need to eliminate units, an unworkable equity structure, desire to sell or merge with another entity, threat of franchisee litigation, desire to refinance but the lender has expressed concern about financial or other issues.’<sup>6</sup>
- f. “Failure as a result of “franchising-related” factors, are seen by Cross as falling essentially into five key categories:
1. Business fraud
  2. Intrasystem competition, involving franchise outlets being located too close
  3. Insufficient support of franchisees
  4. Poor franchisee screening
  5. Persistent franchisor-franchisee conflict.”<sup>7</sup>
- g. For **Traveland**, failure of the parent company, Ansett, was the beginning of the end. “Air New Zealand: The Kiwi flag-carrier’s decision to buy Ansett and absorb

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<sup>6</sup> Sarah B. Foster and Carolyn Johnsen, *The War Of The Worlds: Bankruptcy Versus . . .* unpublished paper presented at American Bar Association, 28<sup>th</sup> Annual Forum on Franchising, 2005

<sup>7</sup> In Stanworth, John., Purdy, David and Price Stuart; *Franchise growth and failure in the USA and the UK: a troubled dreamworld revisited* Franchising Research: An International Journal Volume 2 Number 2 1997 pp75-94 at 78-79

the much larger airline destroyed both<sup>8</sup>. Insufficient due diligence and the need to upgrade Ansett's ageing fleet were among Air NZ's problems<sup>9</sup>."

4. **If franchisors fail their franchisees buy out the network.**
  - a. Occasionally franchisee groups do buy a failing franchisor but this is not usually the case. Eg Kleins – no buyer could be found within the tight time frame available to the administrator.
  - b. Refer to Appendix 1.
5. **Only fledgling franchisors risk failing, so there will not be too many franchisees impacted if a franchisor goes into administration or becomes insolvent.**
  - a. Not true
  - b. See Annexure 1
6. **Franchisor is a single legal entity.** While the 'franchisor' is a single legal entity, the franchisor is a key entity within a network. For example, Traveland Pty Ltd was one of 40+ subsidiary entities of Ansett Airlines, and the Kleins jewellery franchisor network was made up of 3 companies named in media reports and a further 10 not mentioned in any media reports. The franchisor' should not be dealt with as a single entity.
7. **The franchisees' loss can be attributed to their failure to do proper due diligence before they committed to the relationship.** The franchisor is not required to identify the possible consequences of the franchisor going into administration or becoming insolvent for individual franchisees. This means the franchisee does not think it could happen and, as a consequence, can not self-protect. I conducted research (funded by CPA Australia) on what happens to franchisees when the franchisor fails<sup>10</sup>. The single biggest impediment to conducting the research was the difficulty of retrieving information about the legal identity of franchisors from the public registry.

According to the 2006 Franchising Australia Survey, 'more than two thirds of franchisors are organised as private companies. Fourteen percent operate as public companies and a further 10 percent are organised as trusts.<sup>11</sup> A franchisee conducting due diligence to

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<sup>8</sup> in fact, Air New Zealand is still flying in 2004

<sup>9</sup> Paxinos, Stathi Ansett from A to T, Sunday Age 17 February, 2002

<sup>10</sup> [http://www.cpaaustralia.com.au/cps/rde/xchg/cpa/hs.xsl/726\\_17547\\_ENA\\_HTML.htm](http://www.cpaaustralia.com.au/cps/rde/xchg/cpa/hs.xsl/726_17547_ENA_HTML.htm)

<sup>11</sup> Frazer, L., Weaven, S., and Wright, O., *Franchising Australia: 2006* Griffith University, p.34

verify information disclosed by the franchisor is potentially confronted with three problems.

- a. If the franchise is owned by a public company, there will be very little information that is specific to the wholly owned franchisor subsidiary in the published annual returns of the public company.
- b. While it is relatively easy and inexpensive to conduct a search of a proprietary (private) company, franchisors often operate their business through many more than one legal entity. The more entities there are, the more expensive and difficult it becomes to conduct a robust due diligence.
- c. The nature of a trust means that it is impossible to conduct due diligence about it. For example in *Australian Competition And Consumer Commission v Chaste Corporation Pty Ltd (In Liquidation) (ACN 089 837 329)*, *Braddon Ralph Webb, Orlawood Pty Ltd (ACN 059 294 334)*, *Peter Clarence Foster, Sean Petrie Allen Cousins, Kevin Anthony McMullan, Alan Kenneth Cooper, Stephen D'alton*, Lander J in the Federal Court in Queensland observed: 'Chaste was entirely controlled by the fourth respondent, Mr Foster and the second respondent, Mr Webb, and those two gentlemen, through the entities which they controlled, namely, WMMT and WFDT<sup>12</sup>, would receive respectively 75 per cent and 25 per cent of the profits. As far as a bystander was concerned, Chaste was entirely controlled by Mr Webb. No bystander could have known that there were agreements in place between the second and third respondents and the fourth respondent, and an entity controlled by the fourth respondent which gave control of Chaste to Mr Foster.'<sup>13</sup>.

It should also be noted that;

- a. Sometimes not even the court can work out who the franchisor was, as is demonstrated in comments by Graham J in *Acer Computer Australia Pty Limited v Carter (No 2) [2007]* "2 The relevant franchisor would appear to have been one ... of the companies in the 'Beta Group,' which comprised Beta Stores Limited ACN 009 710 605 ('Beta Stores'), Beta Stores (Southern) Pty Limited ACN 059 881 220 ('BSS'), Beta Stores (Northern) Pty Limited ACN 112 330 944 ('BSN'), A.K. Truscott Investments Pty Limited ACN 007 818 493, Truscott Electronics Pty Limited ACN 007 549 206 ('TE'), Truscott Finance Pty Limited ACN 007 598 389, PGA & Associates Pty Limited ACN 007 755 615 and BSL Finance Pty Limited ACN 058 061 822 ('BSLF')."
  - b. Franchise agreements last from a short term of 3 years to, in some cases 35 years, in some, indefinitely. It is impossible to conduct due diligence that sees far into the future.
- 8. Franchisees enter a contractual relationship with their franchisor. They are both business people. They can negotiate terms that will protect them if the franchisor fails. There is very limited opportunity for franchisees and in some cases for master franchisees, to negotiate any significant amendments to the single unit franchise**

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<sup>12</sup> Two trusts; In 2006, 10% of Australian franchisor were operated by trusts according to Frazer, I., Weaven, s. and Wright, O., 2006 Franchising Australia Survey, 34.

<sup>13</sup> Qud 252 of 2001 [22 and 24].

agreement. Research conducted by several academics<sup>14</sup> supports this. Franchisees remain vulnerable consumers despite s 51AC. The franchisor drafts the franchise agreement. That fact automatically puts them in the driver's seat in relation to the contents of the agreement. It is heavily weighted in the franchisor's favour.

9. **Franchisees of failed franchisors are protected by the Franchising Code of Conduct.** The Australian Competition and Consumer Commission is of the view that the Code does not apply to liquidators (this seems correct from an insolvency policy perspective). Some administrators also believe themselves not to be bound by the Code although from a policy perspective this seems like an untenable position (this seems incorrect from an insolvency policy perspective). Neither position has been tested in court.
10. **Franchisees are creditors in the franchisor's insolvency; they are 'taken care of' already.** For the bulk of the franchisee's investment, the franchisee is not a creditor. What would make a franchisee a creditor? Using Kleins and Traveland franchisees as an example:
- a. Unusually, the Kleins franchise agreement contained a guarantee that if annual turnover did not reach a certain level, the franchisor would pay the franchisee an agreed sum of money. Anecdotally, many franchisees received or were entitled to receive these payments. For this money, they are a creditor.
  - b. If a franchisor had agreed to pay franchisee money following a mediation, but had not yet paid the money, that franchisee is a creditor (probably unsecured) for the unpaid part of this money.
  - c. Moneys may be owed to a franchisee under a judgment debt (for example following the Cut Price Deli litigation)
  - d. Some of the Traveland franchisees were owed money by the franchisor in connection with airline ticket refunds.
  - e. Small amounts will be owing to Kleins franchisees by the supplier of the group in respect of the inevitable occasional faulty items of jewellery.
  - f. May be a creditor in relation to any rent payments that the franchisor received from the franchisee but did not pass on to the landlord.
  - g. If a franchisee does not fit into a category as a creditor, the administrator or liquidator may elect to add them to the list of creditors at \$1. The value of a creditor's interest has a bearing on their voting rights at a creditors meeting.
  - h. Sometime a franchise is structured more like a commission agency – the franchisor collects money from the customers and pays it to franchisees. In this case, any money currently owing to franchisees would support their claim as a creditor.
11. **Franchisees know there is a risk in buying a business.** Franchisees take it as a given that the franchisee has a proven business. Neither the franchisees, their advisers nor their financier gives a thought to the possibility that the franchisor might become insolvent. There is no warning of the possibility of the franchisor failing in the consumer

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<sup>14</sup> Including Gillian Hadfield, Stephen Corones, Elizabeth Spencer

protection legislation, the franchise agreement, the Disclosure Document provided under the Code, the ACCC website, the State and territory Government franchise websites, the FCA website, etc.

**12. If franchisor failure is an unresolved legal issue in Australia, the law has a solution in other countries.** No. I can provide more information about this if it interests the Committee.

Thank you for the opportunity to make this submission.

Jenny Buchan

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## APPENDIX 1

### 64 Franchisors in administration or insolvent in Australia – a very incomplete list

trading name	started trading	started franchising	ASIC status 0605	Admin/ Liq apptd	# fees	Years trading	years franchising
A1 Mobile Radiator Repairs	?	1997	DRGD	1999	4	2	2
Aizeema	?	?	?	1992		?	?
Allied Securities	1998	?	SOFF	2001	1160	?	?
Arby's	1995	?	DRGD	2000		?	?
Archem	?	?	EXAD	2005		?	?
BC The Body Club	?	?			2	?	?
Betta Electrical Ltd	?	?	EXAD	2006	300	?	?
Brash's (WAS IT A FRANCHISE?)	?	?	?	1998	105	?	?
Budget rental cars	?	?	?			?	?
Carlovers	?	?	?	2003	37	?	?
Cassidy's	?	?	?			?	?
Century 21 Pty Ltd	1988	1988	DRGD	1998		2	2
Cheque Exchange		1998	DRGD	2001	60		4
Collins Booksellers	1929	?	EXAD	2005	20	76	0
Cut Price Deli	1974	1984	DRGD	1995	150	21	11
Danoz Direct	1998	?	EXAD	2005	26	7	1
Data Vault	2002	?	EXAD	2004		2	2
Delifrance (Australian arm)	1995	?	EXAD	2003	19	8	0
Denny's	1986	?	DRGD	1994	?	?	?
Fair Dinkum Bargains	?	?	EXAD	?			?
Fuddruckers	1981	?	REGD	?			?
Furniture Wizard	1996	maybe 1998	DRGD	1999	35	3	0
Global Prepaid Comms.				2003	23		
Great Australian Ice Creamery	1977	1982	DRGD	1998	62	21	16
ie Networks	2004	?	EXAD	2005		1	0
Juice Station	1996	?	EXAD	2005	17	9	0
Kernels Popcorn	1996	2002?	EXAD	2005	25	6	1.5
King of Croissant	1997	?	EXAD	2002		5	0
Kleins	1982	19XX	EXAD	2008	134	26	17(est)
Lloyd Scott Enterprises	1984	?	EXAD	2001		17	0
Mermaid's Catch							
Mini Tankers International	1991	?	EXAD	2003	200	12	0

Mobile Computer Cleaning	1997	?	EXAD	2003	56	6	0
Modern Garages	1988	1994	DRGD	1999		11	5
Mystic Crystals	1993	?	EXAD	1999	2	6	0
NoRegrets	1998	?	EXAD	2002	600	4	0
Nrgize		?	EXAD	2005	17	3	0
Office Support Services	2001	?	SOFF	2004	?	3	0
Old Papa's Café	2000	?	EXAD	2002	3	2	0
On Time Copy Centre	1997	1998	EXAD	2000	17	3	3
Only \$2	1999	?	EXAD	2005	25	6	0
Ozzie Disccount Software			DRGD	1992	?		
Party Land	2000	?	EXAD	2005	3	5	0
Personal Actions	1992	?	DRGD	2003	?	11	0
Photo Safe	2002		EXAD	2004	?	2	0
Pulp and Go-man-go				2006	18	?	?
Roger David			DRGD	2003	4	?	?
Rugs Galore	1991	?	EXAD	2002	4	11	0
Sam's Seafood	?	2004	EXAD	2005	16	1	1
Simply No-Knead	1985	1989	DRGD	2000	5	15	11
Sizzler					?		
Snow Deli	1987	?	DRGD	1990	10	3	3
Soils Ain't Soils	1980	?	EXAD	2003	4	23	0
Speeds Shoes	1910	1989	EXAD	2004	75	94	15
Stockmans Australian Café	1990		DRGD	2002	48	12	?
Synergy in Business	?	1999	DRGD	2002	31	3	3
The Keg	1998		DRGD	2004			
Tokyo Joe's	?	?	DRGD	2003	6	1	0
Top Snack Foods	1994	?	DRGD	2000	5	6	6
Traveland	1958	1990?	EXAD	2001	270	43	11
TRIMit	1999	?	EXAD	2001	70	2	0
Wonderland of Pets	1994	?	DRGD	1996	3	2	2
Zafco Franchise Co Pty Ltd		2006					