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Franchising Review Secretariat Unit
Small and Family Business Division
The Treasury,
Langton Crescent
PARKES ACT 2600

Also by email: franchisingreview@treasury.gov.au

**SUBMISSION TO FRANCHISING REVIEW SECRETARIAT UNIT,
SMALL AND FAMILY BUSINESS DIVISION,
THE TREASURY, COMMONWEALTH OF AUSTRALIA**

Dear Sir/Madam

Review of the Franchising Code of Conduct

BACKGROUND:

I write on the basis of extensive and continuing experience over the last ten (10) years, working with franchisees across a range of industries but particularly, in the convenience store, fuel and food industries.

Our firm brought Class Action proceedings in the Federal Court of Australia against 7-Eleven which resulted in a \$98m settlement in July, 2021, approved in February, 2023.

We have also acted for franchisees in their disputes with banks which have lent to them, pursuant to *tri-partite* arrangements with franchisors, even though the serviceability of the loans was questionable and the only default security in the event of a default was the franchisee's home.

I have represented franchisees in disputes, in mediations and at mediations, to attempt to resolve their grievances with franchisors including Dominos Pizza (D.P.E.), Pizza Hut (Yum! Brands), Oporto, Red Rooster (Craveable Brands), Caltex, Sharetea Australia, United Petroleum and Pie Face) and ongoing issues with 7-Eleven Stores Pty Limited.

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A. ROOT PROBLEMS FACED BY FRANCHISEES:

I have personally come into contact with literally thousands of franchisees, an overwhelming majority of whom hail from the Indian Sub-Continent (India, Pakistan, Nepal and Bangladesh), and from PR China, Vietnam and the Phillipines.

The reason for this are:

1. New immigrants find it difficult to obtain finance to invest in small businesses unless there is a strong third party, such as a franchisor, providing some form of collateral to their lender;
2. Franchisors have frequently been prepared to stand behind franchisee loans via *tri-partite* arrangements with the bank and the borrower (the bank acts frequently in conflict of interest, where it is unclear whether its customer is the borrower, the franchisee/guarantor or the franchisor). Secondly, even where formal *tri-partite* arrangements are not in place, there are understandings or accommodations between franchisors and banks to make concessional arrangements to facilitate prospective franchisees buying a franchise business;
3. New migrants are neophytes to the Australian marketplace; they have minimal understanding or knowledge of the *Australian Fair Work Act, 2009 (C'th)*, Industrial Awards and EBAs and of their own common law rights and under the Australian Consumer Law.
4. They mostly have no tradition of collective action and tend to be pusillanimous when it comes to standing up to a franchisor.
5. They tend to rely upon legal and financial advisors from their own communities who lack the relevant expertise to advise them properly with respect to the undertakings and commitments which they are assuming by entering into a franchise.

Generally, there is no assured renewal of a franchise term so franchisees frequently borrow a significant proportion of the money which they invest, pursuant to a loan, repayable within the term of the franchise.

The franchise term is generally five (5) or ten (10) years or the balance of the term of the franchised store lease, whichever is the shorter.

If a franchisee takes out a loan in reliance on the expectation that a lease will be renewed and it is not, the franchisee may be left with no franchise business but just with debt. Additionally, the repayments are usually of both interest and principal, fully reducible over the term of the Franchise Agreement, which frequently means that the franchisee works just to pay for the franchised business by repaying the bank with interest, with little then left over for the amenities of life, after meeting all of the business' overheads.

With some franchisors, including 7-Eleven, there is split of gross revenue before business overheads are met, leaving the franchisee with all of the expenses and there is often not enough left over to pay wages, B.A.S. debts and also to provide for a living wage for the franchisee, to meet his loan repayments and feed himself and his family.

The most common outcome where the franchisee is being squeezed by the franchisor is that the ATO becomes the big loser.

RECOMMENDATION 1:

The reform for which I have long contended is that every Franchise Agreement should require employee wages, group tax, and GST to be paid and for salary and emoluments to be paid at the Award Rate for a store manager, to the franchisee's working directors, from gross revenue ahead of any distribution to the franchisor.

DISCRIMINATION:

Where a franchisor operates corporate stores alongside franchised stores, franchised stores frequently receive better treatment. This is true particularly when there is competition between corporate and franchised fuel stores.

For example in Perth, among 7-Eleven franchised fuel stores, we are instructed that there is petrol price discrimination in favour of the corporate stores and against the franchised stores.

Franchised stores are also charged for fuel “drive-offs”, treated by 7-Eleven Stores as if the fuel had actually been sold. The franchisee is not only required to bear the cost of the stolen fuel but is also charged 7-Eleven’s retail mark-up plus GST on the fuel theft. 7-Eleven thereby profits from fuel larceny at the expense of the franchisee.

RECOMMENDATION 2:

The burden of theft should be shared equitably between franchisor and franchisee.

REBATES AND UNILATERAL PROFITEERING BY FRANCHISOR:

Frequently franchisees are enticed into acquiring a franchise business because they want to derive a benefit from trading in an established brand with the goodwill which they perceive as being attached to it, and their expectation that they will be able to obtain favourable wholesale pricing based upon the economies of scale which a franchisor can achieve through the substantial price leverage and buying power available to the network which it controls.

However, it is very often the case that the franchisee does not receive any benefit or any significant benefit from more favourable pricing because the franchisor reaps and keeps all or almost all of the benefits for itself, in terms of perquisites, incentives and rebates received from its appointed suppliers, without passing them on to the franchisees.

Indeed, it is frequently the case that some food franchisees pay more for some goods than they could acquire them off the shelf, at Coles or Woolworths.

It is also the position that amongst many food franchises and also convenience store franchises, operated in fuel franchises, franchisees are required to accept or purchase minimum quantities of goods and products for resale, sometimes of unpopular brands and already close to their “best before” or “use by” dates.

If the products are not sold before their expiry, the franchisee is forced to pay for them.

Franchisors benefit from the “top line” while franchisees depend on the “bottom line”. Promotions and marketing campaigns, vouchers and discounts instigated by franchisors, often increase traffic into stores but they also increase overheads while also reducing the “bottom line” for the franchisee.

What is good for the franchisor is not necessarily good for the franchisee. Franchisees are often forced to sell goods for no or minimal profit in order to increase sales revenue but the added cost of providing these benefits to customers, seriously erodes franchisees’ access to profit.

In food franchises, delivery charges, Menulog, Uber Eats and the administrative expenses associated with providing these delivery services, are all charged to the franchisee as an overhead.

Most commonly, the franchisor is the head lessor and the franchisee has a sub-lease or licence.

There is commonly a lack of transparency and accountability by franchisors with respect to rent charges and rent subsidies, discounts and rebates and, during COVID-19, of rental concessions. This lack of accountability also extends to the landlord's contribution to fit-out.

Franchisees are frequently required to fit-out stores or to refurbish them. The costs of the refurbishment invariably exceed the price for which the franchisee could commission the same work from its own tradesmen but the franchisor insists that its demanded price, and its own contractors be paid by the franchisee, with the result that there is often likely a substantial undisclosed profit reaped by the franchisor from the capital works, for which it does not hold itself accountable to the franchisee.

RECOMMENDATION 3:

Undisclosed margins and commission with respect to capital works should be rendered unlawful and criminalised.

RECOMMENDATION 4:

The full benefit from rebates, perquisites and incentives received by the franchisor must be disclosed and at least 50% thereof, passed on without deduction, to the franchisee.

THE TYRANNY OF FRANCHISING

Particularly where there is an opportunity for franchisors to impose plant and equipment acquisition requirements on franchisees, including for motor vehicles, kitchen equipment and software, without limitation, franchisors typically require franchisees to purchase specific plant and equipment which may be of a grade in excess of their needs, or to pay for software systems which are also not necessarily adapted to franchisee requirements. They are required to purchase plant or equipment of a particular brand or model, commonly at a premium price and masked by the opportunity for the franchisor to introduce a finance or leasing company to the franchisee to allow the franchisee to purchase with interest on a payment instalment arrangement. The franchisor may receive a trail or commission on the funding of the acquisition as well as a rebate or incentive in respect of the procurement of the software or plant and equipment.

This often adds substantially to the overheads of the franchisee with little return to the franchisee but is of continuing ongoing benefit to the franchisor. Not unfrequently, what is being forcibly acquired is to improve the franchisor's ability to monitor the franchisee's performance, at the franchisee's sole expense.

Another almost universal practice amongst franchisors is to bury in a "Manual", which a franchisee does get until after it becomes a franchisee, many of the more onerous terms, conditions and obligations unilaterally imposed on the franchisee by the franchisor.

The franchisor arrogates to itself the opportunity to introduce such new imposts on the franchisee which may change the nature and extent of the obligations of the franchisee toward the franchisor, as the franchisor sees fit to impose.

In food franchises, this commonly involves the requirement for franchisees to purchase minimum quantities from only approved supplies which may result in a capital drain on the franchisee, by dint of the franchisee having to acquire stock in excess of its needs and being left with the burden

of having to pay for what it is not able to sell before the expiration of the “best before” or “use by” date, as the case may be.

Pricing policies are frequently set by the franchisor’s Head Office without regard to regional differences in demand and are often unsustainable for franchisees in particular territories.

It is standard for franchisors to impose a marketing levy and although the franchisee has the opportunity to see the audited statement of how the marketing levy has been expended, it often appears that the franchisor has shifted administrative and back office expenses into the marketing budget. What is the franchisee to do about it when it discovers that this has occurred? Generally, franchisees lack the financial capacity and concerted resolve to hold the franchisor to account in the face of such intermingling of expenses.

RECOMMENDATION 5:

- a) No capital imposts can be imposed on a franchisee, without the franchisor fully disclosing to the franchisee franchisor trails, commissions and incentives;*
- b) No spending requirements can be imposed on a franchisee which are not consensual or which cannot reasonably be regarded as being in the best interests of the franchisee.*

THE FORGOTTEN FRANCHISEE:

Franchisees and their families are frequently locked in to working for nominal wages up to 60 to 70 hours per week.

Sometimes they have to go without take-home pay because the cost of meeting their other essential financial commitments completely erodes the amount left over to meet the franchised business’ overheads after the split of gross revenue with the franchisor, mandated under their Franchising Agreement.

A fair salary package for key franchisee personnel including at management level (who will also mostly be the directors of the franchisee company) should be enshrined into Franchise Agreements so that the nominated working directors should be paid their salaries and statutory emoluments ahead of any split of gross revenue.

RECOMMENDATION 6:

A fair day’s work for a fair day’s pay at the Award rate applicable to a fuel store manager, should be written into all Franchise Agreements as a priority payment – ahead of any split of gross revenue.

WEAPONISING THE BREACH MECHANISM:

Franchisors frequently look for ways to induce, engineer or use entrapment to uncover fault by a franchisee, in order to use it as a pretext to allege fraudulent conduct or repeated breaches (3 strikes and your out) under clause 29 of the Franchising Code and clause 36 of the Oil Code, entitling the Franchisor under the Codes to terminate a franchise summarily without a requirement to offer adequate compensation.

Most Franchise Agreements are silent on offering fair compensation on termination of the franchise or contain provisions to the opposite effect.

I am aware that Caltex made use of this strategy in order to eliminate many franchisees. United Petroleum and 7-Eleven resort to similar tactics.

The conduct of the franchisor in exercising its purported right to terminate is self-serving, arbitrary, peremptory and does not involve affording natural justice to the franchisee.

In general, the franchisee is made to pay for the costs of an audit, regardless of the outcome of the audit. Recently, Craveable Brands audited Oporto franchisees to see whether they had obtained the contemporaneously signed consent of casual workers to a change of roster going back several years. (Caltex used similar tactics to default its franchisees. Curiously, they both had the same CEO).

The contravention of this obscure requirement was treated far more seriously by Oporto than it has been regarded by the Fair Work Commission. The costs of the audit frequently exceeded the magnitude of any contraventions of the relevant Award but were a burden that the franchisee was made to bear.

Franchisors often do not discharge their responsibility to educate franchisees as part of the process of holding them accountable.

Indeed, franchisors typically make franchisees fully accountable, without co-responsibility being accepted by the franchisor, regardless of context.

RECOMMENDATION 7:

- (i) *No unilateral termination without leave of a Court or Tribunal;*
- (ii) *No unilateral imposition of fines or charges by franchisors on a franchisee.*

UNFAIR PRACTICES:

Dominos Pizza (D.P.E.) does not guarantee franchisees untrammelled territories.

When a franchisee substantially boosts its revenue or profitability, Dominos requires the franchisee to “split” its customer base between its existing store and a new store, to be opened to feed off a substantially intersecting market in an adjacent territory.

This usually involves a doubling of overheads with only a modest increase in turnover, leading to decreased profitability or unprofitability for the franchisee. Its businesses lose value, with increased expenses and reduced profitability.

The practice of franchisors in unilaterally determining whether to renew a lease of premises from which a franchised business operates or whether to exercise an option and to exclude franchisees from all lease negotiations, coupled with the lack of guarantee of a further franchise or lease term, imperils the franchisee’s investment in a way which is not necessarily foreseeable when the initial decision to acquire the franchise is made.

RECOMMENDATION 8:

1. *The franchisor must not be permitted unreasonably to make or implement a decision which is likely to harm the franchisee’s business.*

MANIPULATING THE MARKET FOR FRANCHISED STORES:

Franchisors typically use purported quality control or quality assurance mechanisms to intimidate or exclude a franchisee from the franchise.

It is common in the pizza industry for franchisees to be failed arbitrarily by the franchisor's inspectors when they have just passed a Local Government hygiene inspection.

There is a lack of synergy between Local Government food hygiene requirements and the stipulations of the franchisor, which are used to breach franchisees, often without any justification or foundation.

When three (3) cumulative breaches can be used under the Oil Code to terminate a Franchise Agreement summarily and when termination has the dire consequence of leaving the franchisee without a compensation mechanism for the value of the forfeited business which it acquired, the tactic of franchisors to weaponise tendentious breach notices as a weapon against franchisees should be eliminated.

Under the existing Codes and Franchise Agreements, there are not bilateral obligations of equal force on franchisee and franchisor. The franchisor gets the much easier ride. The consequences of a franchisor's breach or default under a Franchise Agreement are specifically not contemplated in the Oil Code or the Franchising Code.

The ability of the franchisor to terminate the franchise without paying compensation, where it can rely upon fraud (clause 29(g)) of the Franchising Code and clause 36(e) of the Oil Code) involves the imposition of a penalty which does not represent a genuine pre-estimate of loss or damage suffered by the franchisor as a result of the franchisee's default or breach. However, franchisors seek to avoid the common law in this respect by claiming that the franchisee in effect owns nothing other than a licence to trade on the franchisor's goodwill, which the franchisor is entitled to revoke and hence, there is virtually nothing that the franchisee retains of value for which the franchisor should pay post-termination.

The franchisee commonly acquires its franchised business from an outgoing franchisee and only needs the approval of the franchisor to take over the franchise. The franchisee will then pay a franchise fee to the franchisor and become liable for the ongoing contributions which the franchisee is required to make to the franchisor, for example, for royalties, marketing expenses and also the obligation which it assumes to purchase only from the franchisor's approved suppliers, who do not necessarily sell premium products and further, who are often more expensive for fungible products that can be sourced elsewhere.

The process of issuing breach notices to franchisees is weaponized by franchisors, to deter complaints and concerted action by them.

The service of "breach" notices and imposition of penalties and the decision to terminate is discretionary, at the sole instance of the franchisor.

Because of the power and financial imbalance between franchisor and franchisee, the franchisee has little capacity to resist a hostile determination by the franchisor. Many have sunk most of their savings and resources into the franchised business.

A decision to terminate the franchisee's tenure is financially devastating to the franchisee whose directors or their families commonly own most, if not all, of the equity in the franchised business

and rely upon it to generate the income from which they pay their mortgage or rent and feed themselves and their families.

The arbitrary application of penalties by the franchisor against the franchisee does not involve any compliance with rules of natural justice, due process or, in most instances, the franchisee being in a position to exercise the right to be heard prior to termination occurring. The franchisees' ability to access legal services is constrained by what is frequently their lack of financial resources, particularly post-termination.

Franchisors are in a position to control the resale of franchised businesses by using the mechanism of being able to approve or withhold approval of proposed purchasers/incoming franchisees.

While the Franchising Code and Oil Code set out some criteria for approval of the franchising candidate which the franchisor may consider, the list is not exhaustive and a deemed acceptance only occurs when a request for approval of a franchisee has been made in writing and inordinately delayed.

Additionally, in practice, a franchisee will not want to acquire a franchised business in an enterprise which does not want him as a franchisee. There are only so many hurdles over which a prospective franchisee might be prepared to climb, in order to invest in a franchised business.

Some franchisors make franchisees submit business plans over and over again, which they will approve or mostly disapprove, at their whim.

They apply inconsistent criteria to the approval of a nominee franchisee and are not transparent as to whether or why they will approve or disapprove of him or her.

It is often the case that when a franchisee introduces a franchising candidate as a prospective purchaser, the franchisor will dissuade the franchisee from making the purchase of the store which he was introduced to buy, and divert him to consider buying a different store.

Franchisors will frequently try to depress the price for a store by telling the prospective purchaser that he would be paying "too much". This is often done disingenuously in order to continue to frustrate prospective sales so that the franchisor can see the outgoing franchisee's franchise term run out before the franchisee is able to secure a sale of his franchised business, leaving a buy-back by the franchisor at a very low price, as "an offer that the franchisee can't refuse", being made on the death knell of the franchise term.

The price offered by the franchisor on buy-back will often be as low as just 10% of the market price. Such unconscionable conduct by franchisors is commonplace and usually accompanied by the franchisor demanding that the franchisee execute a Deed of Release in its favour, as a condition of the unjust buy-back proceeding.

Desperate franchisees will do desperate things.

RECOMMENDATION 9:

- (a) The Franchisor should not play any role in the franchised business sale/purchase process other than to be able to approve or reject a franchising candidate within fourteen (14) days of being requested to do so, on grounds which should be prescribed by law and codified.*
- (b) A franchisor's failure to communicate a decision on the candidate within fourteen (14) days with reasons, will constitute a deemed approval.*

CONFIDENTIAL OR DECEITFUL?

Another practice commonly adopted by franchisors and particularly by United Petroleum, is to incorporate comprehensive, excessive and onerous confidentiality terms in its Franchise Agreement.

These terms are enforced against franchisees in order to intimidate them from speaking out publicly about the oppressive conduct of a franchisor and to preclude whistleblowing activity.

For example, sanctions have been applied to two (2) franchisees who exposed unlawful practices by the franchisor to Government agencies and the media, concerning unleaded petrol, falsely marketed by the franchisor as complying, pastries sold as carrying a valid Halal certificate, which they did not – and under-strength hand sanitiser, sold during the COVID -19 Pandemic, at risk to the public.

Practically, a franchisor can require franchisees to merchandise products which are sub-standard to the franchisor's knowledge, and although such conduct is unlawful, there is little that a franchisee can do about it with impunity, insofar as the franchisor is concerned.

RECOMMENDATION 10:

The Corporations Act to be amended to provide for whistleblower coverage under Part 9.4AAA to be extended to protect franchisees, their directors and employees.

RECOMMENDATION 11:

Confidentiality terms should be limited and read down to protect to what is strictly necessary to protect the lawful business systems and IP of the franchisor, and nothing more.

Franchise Agreements are stacked in favour of the franchisor. The problem cannot be addressed by merely requiring an intending franchisee to obtain a certificate of independent legal or financial advice or through stricter or more comprehensive disclosure requirements.

Typically franchisees use lawyers and financial advisors from their own ethnic communities, who often have a conflict of interest (for example, they know the seller) or are professional advisors to whom the franchisee was referred by the franchisor and hence, may be conflicted.

Moreover, Franchise Agreements are treated as being immutable – not negotiable - like bank mortgages, and new immigrants often have limited options, with franchising as their only way to get into small business; their borrowing capacity is limited given their lack of any track history in Australia.

RECOMMENDATION 12:

The Franchising Code and the Oil Code are both damp squibs, barely and rarely enforced, even by the Courts, let alone by the regulator. They should each be replaced or substantially supplemented, by comprehensive legislation,

which incorporates mandatory and prohibitive clauses and a real offence regime, where meaningful penalties are imposed upon wrongdoers, which count as criminal convictions and do not merely provide for civil penalties.

With compliments

Stewart A Levitt

B.A, LL.B., (UNSW), LL.M., (Uni.Syd), M.DR (UTS)

Senior Partner
Levitt Robinson Solicitors
Sydney