

**Submission by Stephen Hansen to Mr Alan Wein in relation to the Department of Industry, Innovation, Science, Research and Tertiary Education, Discussion Paper: Review of the Franchising Code of Conduct 2013.**

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Dear Mr Wein

I have been involved in franchising in Western Australia since 1983, I was a franchisee (for 8 years) of Chicken World and Big Rooster, a franchisor of CHOOKS fresh & tasty (for 19 years) and now have various franchisor and franchisee interests in Western Australia.

I have been involved with the Franchise Council of Australia since 1995 and was State President for 5 years and also sat on the National board during that time.

I have a Diploma in Business (Franchising) and was awarded The Paddy Thompson Award in 2007 for my contribution to the Franchising industry in Western Australia.

Over the years I have been able to meet with many people in franchising, including franchisees, franchisors and consultants and in doing so I have been able to not only gain contacts but more importantly to be able to gauge how franchising is going across Australia.

After trips to the USA in 2010 and 2011 I can say that Franchising in Australia is very healthy and the statistics that I have seen indicate that we have the lowest rate of dispute in the world.

Franchising is well regulated federally and it does not require further regulation.

I have not had any complaints about any systems in Western Australia, but I do believe that a register of all franchise systems, suppliers and franchisees could be a tool that could assist the sector.

I cannot see why our sector should be penalized by unwanted and unnecessary increased legislation.

With respect to any provision for Good Faith I believe that this is not something that can be legislated for, as is the case for leasing, however if there is real understanding of how Franchising works then the major 8 points of a franchise need to be understood by all parties before any decisions are taken. Those eight points are:

1. Term
2. Royalties
3. Franchise fee
4. Advertising levies
5. Image and upgrades
6. Goodwill
7. Renewal
8. Training

Education is the key, otherwise many people will continue to enter into agreements with their eyes closed. Thus we all know what happens every day in many transactions that are outside of franchising.

I would also point out that although prior to the Code of Conduct, a system called Cut Price Deli which had over 100 franchisees, was brought to its knees by two Rogue Franchisees, and the Franchisor and the Franchisees all lost their businesses. One would think that this type of scenario would not happen today with the code and good mediation. And yet, the franchisor of Ranger Camping was forced into bankruptcy by a rogue franchisee and there are other instances of poor franchisee behaviour that go unreported.

I also had the opportunity to speak with a representative of Competitive Foods in 2010 and when asked what a good faith clause was all about, his comment was this has nothing to do with Franchising, but has everything to do with the war between Yum Corporation and Competitive Foods with relation to Pizza Hut and Domino's, and a day in court.

The majority of franchisors and franchisees in Australia are small business operators. I believe that already the small business operator takes the brunt of over regulation, over taxing (payroll tax) and bureaucratic inefficiency. There seems no reason to increase this.

My specific answers to the points raised and my other comments to the discussion paper to the review of the Franchising Code of Conduct are attached.

Yours sincerely



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#### Page 10 –Introduction of State Private Members Bills

I would challenge you to ask questions as to why there were a number of state enquiries? Who requested or caused these enquiries? How much time and tax payers' money was expended and for what result?

#### Page 13 - Franchise failure

- (1) Has the additional disclosure requirement regarding the potential for franchisor failure effectively addressed concerns about franchisees entering into franchise agreements without considering the risk of franchisor failure?

Franchise failure can be caused by either party – the franchisor or the franchisee/s. What happens when this is actually brought about by franchisees eg Cut Price Deli, Ranger Camping, is that the landlord still needs a tenant, the supplier still needs sales, the franchise arrangements are usually on-sold by a receiver or administrator to another party and business goes on. The legislation or disclosure is not going to make any difference.

There is a very low percentage of franchisor failure in Australia.

- (2) Does the sector have any concerns regarding the operation of this requirement?

I don't have any concerns about this requirement.

#### Page 14 - Expenditure and other payments

- (3) Have amendments to the Franchising Code improved the transparency of financial information for franchisees? If not, why not? If so, what benefit is this having for franchisees?

Yes, the amendments have improved the transparency. However, I believe best practice would be for education to be mandatory for prospective franchisees to undertake prior to signing a franchise agreement, that education to include explanations about attribution of legal costs, capital expenditure, rebates, marketing funds, lease arrangements and demographic studies. My recommendation is that the education take into consideration the eight points of a franchise which were mentioned in my introduction.

- (4) Does the sector have any concerns regarding the operation of these amendments?

Yes, see above.

#### Page 16 - Contract variation, transfer and novation

- (5) Have the amendments regarding unilateral variation, transfer and novation been effective in addressing concerns about franchisors' ability to make changes to franchise agreements? Why or why not?

This section needs some more definition in order to answer the question. I believe that when a franchise is to be transferred by whatever means, it should be about the outcome which is good for the franchise group, the outgoing franchisee and the incoming franchisee and possibly should form part of the negotiations when a business sells. A franchisor

wants good franchisees. The franchisee wants a term or the comfort to know that he can sell with the protection of the franchisee's goodwill at all times.

(6) Does the sector have any concerns regarding the operation of these amendments?

As above.

#### Page 18 - Disclosure regarding franchisor conduct

(7) Have the changes to the Franchising Code led to improved franchisee knowledge about franchisors and their conduct before they enter into franchise agreements? Why or why not?

They should have. When I was a franchisor, I ensured that all prospects had details of all franchisees and previous franchisees (if we had their permission to disclose their details). Our stance was "talk to everybody and take notice of those who are successful".

(8) Is the information being provided useful to franchisees?

Yes, it should be.

(9) What effect has the requirement to provide this additional information had on franchisors?

I'm not aware of any impact other than an increase in time. It is part of a process and should not cause concern.

(10) Does the sector have any concerns regarding the operation of the new provisions?

No, other than as above.

#### Page 19 - Disclosure exemption for foreign franchisors

(11) What impact has the removal of the foreign franchisor exemption had on the sector?

It has had a positive impact and we should consider that only parties to the agreement should be subject to disclosure.

(12) Has the removal of the exemption caused any issues?

Not to my knowledge.

#### Page 20 - Efficacy of the disclosure amendments as a whole

(13) On the whole, do the 2008 and 2010 disclosure amendments ensure franchisees are provided with adequate information?

Yes. Keep it simple and have a summary sheet with key terms.

(14) Is the extra onus on franchisors justified by the benefit this disclosure is providing to franchisees?

Yes.

Page 21 - Good faith in franchising

Discussion questions:

- (15) How effective were the targeted amendments in 2010 to the Franchising Code in addressing specific issues, instead of inserting an overarching obligation to act in good faith?

The law already says that we will act in good faith, so by asking us to address “instead of inserting an overarching obligation to act in good faith” is a loaded question.

In fact we should not even consider making any change whatsoever. The simple fact that it is mentioned that the insertion of an overarching obligation to act in good faith indicates that someone believes that by giving an option it could actually happen. It seems that questions 15 through 22 would not even be asked if the intention was none other than to push through somehow.

If appropriate for franchising, a similar obligation would also be appropriate for leasing.

- (16) How effective is section 23A of the Franchising Code, which provides that nothing in the common law limits the obligation to act in good faith?

It is ineffective.

- (17) What specific issues would be remedied by inserting an obligation to act in good faith into the Franchising Code which would not otherwise be addressed under the unwritten law or by the Australian Consumer Law?

It wouldn't change the outcome. Although it was possibly perceived by Competitive Foods that it may have given them an opportunity for a day in court.

There is something to be said about the small service systems where franchisees debadge and start the next day using the franchisors intellectual property without any consequence.

- (18) If an explicit obligation of good faith is introduced, should 'good faith' be defined? If so, how should it be defined?

No.

- (19) If an explicit obligation to act in good faith is introduced, what should its scope be? That is, should it extend to: the negotiation of a franchise agreement, and/or the execution of a franchise agreement, and/or the ending of a franchise agreement, and/or dispute resolution in franchising?

This should be agreed at the outset – that negotiation will take place 12 months prior to the end of term, but will be subject to 1. Agreement to pay the franchise fee for a new term; 2. Agreement to pay for Image Upgrade to group's current standard and 3. Compliance with the system. Again, I refer to the eight points of franchising mentioned above. (any franchisee who had been in breach over the term would have a problem at this point.)

- (20) If a specific obligation to act in good faith was introduced into the Franchising Code, what would be an appropriate consequence for breaching such an obligation?

Again, this is a loaded question, it cannot be legislated for as such?

- (21) If a specific obligation to act in good faith was introduced into the Franchising Code, how would such an obligation interact with the provisions of the Australian Consumer Law?

We have common law, so a specific obligation to act in good faith is not required.

- (22) If the Franchising Code was amended to contain an explicit obligation to act in good faith, would there need to be other consequential amendments to the Franchising Code?

No. These questions would not be asked if the intention was not to push for an obligation for good faith. Why not ask some questions that will do some good for the industry?

#### Page 24 - End of term arrangements for franchise agreements

- (23) Have the amendments regarding end of term arrangements and renewal notices been effective in addressing concerns about inappropriate conduct at the end of the term of franchise agreements? Why or why not?

Many within the sector, including Franchisors and Franchisees are not educated to the right level at the outset.

The 8 major points of a franchise and the definitions should be gone over and over and over before they enter into any arrangement.

Exit strategies should also be discussed as a part of initial discussions before commencement not at the end of the term.

All parties need to know that Franchising can work and that it is "Renting a Brand , Name & System for a finite period of time".

The suggestion that 6 months out from end of term negotiations can take place is inadequate. My recommendation is that this could happen 12 months before the end of term. At that point, negotiations need to take place so the franchisor can either assist a non-compliant franchisee to sell or assist him to comply and ensure there is full understanding on the payments of the franchise fee for a further term and payment of any costs towards image upgrade or bringing the business up to the current group standards.

#### Page 26 - Dispute resolution in franchising

- (24) Has conduct and behaviour during mediation changed since the introduction of the 2010 amendments to the Franchising Code, including requiring parties to approach mediation in a reconciliatory manner? If so, in what ways?

No, conduct and behaviour has not changed.

Our general rule has always been that Mediation and Agreement is the quickest, cheapest and most effective, whatever the outcome.

Again if both parties are educated at the outset, most disputes would not arise.

(25) Does the sector have concerns regarding the operation of the amendments?

No.

#### Page 28 - Enforcement of the Franchising Code

(26) Is the current enforcement framework adequate to deal with the conduct in the franchising industry?

Yes, but what mechanisms can be put in place to protect franchisors from dishonest franchisees? As in the case of Cut Price Deli, Ranger Camping and most likely others.

(27) How can compliance with the Franchising Code be improved?

I am not sure that penalties are the real answer. I believe that the answers are in education and maybe making that education mandatory. The issue will be for smaller systems with entry fees of less than say \$50K, how easy is it to sell a deal when there is more red tape.

(28) What additional enforcement options, if any, should be considered in response to breaches of the Franchising Code?

There should be penalties for clear breaches. I think that we need a specific definition of what is "Unconscionable conduct". It seems that there is a grey area whereby a serious breach does not get into this category?

(29) What options are available to businesses to address breaches of the Franchising Code, or any other adverse conduct in the franchising industry?

The options are as per the franchise agreement.