


Discussion Paper:  
2013 Review of the Franchising Code of Conduct

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Prepared for Mr Alan Wein

February 12, 2013

## Abstract

My background is that of aviation as a former commercial airline pilot flying for a United Airlines subsidiary, Trans States Airlines in the United States. My untimely return to Australia in October 2008 saw many layoffs in the aviation industry which made it extremely difficult to find employment in the air transport sector.

I then looked into investing into a small business that eventually lead me to a relatively new company called Pie Face. After many months of talks and market research to verify the information I was given was correct I invested in this company and signed franchise agreements for two locations. After just two months of operation we knew something was wrong and began looking for the reasons even though we had the highest grossing sales store in Queensland. We worked extremely hard with the franchisor to pinpoint the problem only to find that every aspect of our business operations fell within the normal range of a franchisee operated outlet. Realizing that the information provided to us was incomplete and had either understated and/or omitted and misleading expenses, we asked many questions yet got no answers. We then sought legal advice, which eventuated in a 'Notice of Dispute' on our part, we requested to meet and discuss issues as stated in the Franchise Agreements. Pie Face's immediate response was to issue me with two breach notices and eventually terminated both my franchise agreements. So now Pie Face has my whole life savings, as well as over \$800,000.00 in profits from my two outlets alone, not including profits made by the supply of goods which is estimated to be well over \$100,000.00, has left me in a state of bankruptcy, not able to pay over \$100,000.00 in taxes I owe to the ATO, cannot pay suppliers and creditors to the amount of approximately \$200,000.00 and no funds to hire a lawyer to seek retribution or compensation. In the case I could afford a lawyer then I'm told I could possibly recover between 40-70%. The fact that I would be entitled to any recovery at all tells me that there

has been breaches of the law on the part of Pie Face and that I should not only be entitled to full recovery of my initial investment but also the money I should have made under the agreement according to the figures provided to me by the Franchisor.

Upon communication with other franchisees I discovered a systematic problem within the Franchise system. A complaint has been lodged to the ACCC by many pie face franchisees however, we do not have much faith that we can get any kind of fair outcome.

The Commonwealth Government of Australia is losing millions of dollars in unpaid tax revenue that is not paid in so many circumstances that I have described above.

Following are my views on this discussion paper in which I have included my real life experience as a way to convey my views and thoughts on the review questions.

### **Discussion Questions:**

- 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?**
- 2. Does the sector have any concerns regarding the operation of this requirement?**

The requirement to state this information certainly brings it to the attention of the potential franchisee for further consideration. However, many legal practitioners do not discuss this topic when seeking legal advice and potential franchisees are unaware of the legal implications in this case and therefore unaware of their options until it's too late.

No comment on question 2.

- 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?**
- 4. Does the sector have any concerns regarding the operation of these amendments?**

The amendments to the Franchising Code particularly 2010 'opportunity, not opportunism' has good intentions however, items such as significant capital expenditure give franchisors a 'free ticket' to impose their rights whenever they decide to, this can include anytime during the agreement term, but not within the first year in my case. This has the potential to fail many franchisees, since the franchisor has no need to consider the financial position of the franchisee.

- 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?**
- 6. Does the sector have any concerns regarding the operation of these amendments?**

Its understandable that slight variations will have to be made to agreements however, these changes may affect the new owner in a negative way and prevent the sale of the business if the franchisee is desperately seeking to exit the franchise system as in the case with many existing pie face franchisees. I am aware of a pie face franchisee desperate to sell his business due to the store not being profitable as sold to him, only to have his buyer rejected by pie face. This is again an open ticket for franchisors to impose their will. I'm also aware of other franchisees receiving trivial breach notices after they requested their store be put up for sale on the company website. This breach gives the company a right not to list their store for sale and therefor transfer and/or novation. The breach notice in question was for not having adequate stock on display just after the lunchtime rush period ended, all while keeping rostering to a bare minimum according to company standards.

These amendments have the potential for misuse and abuse on the part of the franchisor for which I have provided 2 real life examples.

- 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?**
- 8. Is the information being provided useful to franchisees?**

**9. What effect has the requirement to provide this additional information had on franchisors?**

**10. Does the sector have any concerns regarding the operation of the new provisions?**

NO. It was only after it was too late that I found out the problems that plague the franchising industry and had I known this information beforehand I would have thought twice before entering any agreement and may have prevented the loss of our hard earned savings, a lot of stress, and relationship problems with my wife as a direct result of added stress and uncertainty. It is my understanding that my situation is only one of hundreds just like it, due to franchising. Further, I was given a spreadsheet passed of to me as a profit and loss(P&L) statement which also states that the information is gathered by using historical store data, yet also states that it should not be used in deciding whether or not to purchase the business, but also suggested that I should do my own research as to pie face figures. This is a tactic used by franchisors in the hope the potential franchisee makes errors in their judgment regarding sales figures and expenses, when quite simply the franchisor has the correct figures in the case of existing store and could quite simply supply those to the franchisee. This P&L is a very important document and reveals the health of the business, if I am told not to use it then why was this version provided to me? Such irrelevant information should not be passed on to a potential franchisee, and in my case had omitted and understated figures that misled me. This tactic used by franchisors should not be allowed and serves only to confuse or mislead the potential franchisee into thinking a loss making franchise is in fact profitable.

**11. What impact has the removal of the foreign franchisor exemption had on the sector?**

**12. Has the removal of the exemption caused any issues?**

I cannot comment on these two questions since I have no personal experience of this topic.

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

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

The amendments certainly help the potential franchisee, since with more information they can make a more informed decision. Quite often franchisees are investing their whole life savings into a franchise. This fact should not be taken lightly. A disclosure document is not that difficult to construct and produce to potential franchisees, as well as the fact it is only required once a year.

**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?**

**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?**

**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 ACL?**

**18. If an explicit obligation of good faith is introduced, should 'good faith' be defined? If so, how should it be defined?**

- 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?**
- 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?**
- 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 ACL?**
- 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?**

Questions 15-17 would be better answered by those that have been in the industry for a period of time. I have not been in franchising to provide a constructive discussion for that particular topic.

If good faith is not defined then it remains subject to individual interpretations on what exactly is good faith. A definition of good faith should incorporate any actions of cooperation between the parties, particularly if that cooperation comes at little to no financial cost to either side. It should be short and concise while covering a broad range at the same time, for example, no party shall act in a way that is clearly detrimental to the other side. It would be useful in my opinion to provide some examples as guidelines. A breach of good faith should have a monetary penalty paid to the party that suffered as a result of bad faith. If there are no consequences to acting in bad faith there would be no deterrent rendering any inclusion of a good faith amendment ineffective.



There should be absolutely no doubt that good faith should be introduced to encompass the whole process mentioned in question 19. Why should there not be good faith when negotiating an agreement? Why should there not be good faith in dispute resolution and/or mediation? It is a well known fact that once an agreement has been signed, the franchisor often can impose their own will, leaving the franchisee in a position of helplessness with no bargaining power, and no say in many matters. It is, after all, supposed to be a partnership between franchisor and franchisee.

The motivation of those opposing introduction of good faith in franchising needs to be scrutinized. It is exactly those opponents that are likely to be acting in a manner only beneficial to themselves regardless of the consequences it may have on their franchisees, their partners.

No comment on questions 21 and 22.

**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?**

I have never worked harder in my life as I did during the term of my franchise agreement with pie face. It become my biggest fear that the franchisor can simply refuse to renew my agreement, effectively leaving me with nothing at the end of the term. This particular franchise is well known to issue breaches at will for trivial reasons, which gives them the power to refuse to enter into a new agreement, and much more. The issuance of breaches is subjective and one sided in this instance. Quite simply if they don't want you anymore they can 'get rid of you.'

Further, what does a franchisee get by working hard to improve and/or solidify the brand? In this case the franchisee enters into an agreement, works hard for the good of the

company during the term of the agreement, and leaves the company in a stronger, more robust state.

**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?**

**25. Does the sector have concerns regarding the operation of the amendments?**

I participated in mediation in September, 2012 which was after the 2010 amendment so I can say that without a doubt, my experience was that the franchisor just continued their attack on me to say that I was a bad operator and that it was all my fault for not being able to make the store a success. Of course they took this position only after I sought legal advice on how to deal with the situation in which I found myself, until then I was a model franchisee according to them. The franchisor showed absolutely no interest in resolving our dispute. Why would they? They have no motivation nor incentive to do so. In hindsight, their tactic is one used so often by franchisors in situations like this and that is to drain whatever funds I had left so that I could not move to the next step of litigation and get justice. Without the ability to go to litigation, they win, and I lose big time. Mediation, when one party has absolutely no intention to resolve the dispute, is just a waste of time, resources, and money.

Quite frankly, I do not see the need for confidentiality clauses to be so prolific. This gives the opportunity for franchisors to continue their unconscionable and deceptive conduct to a franchisee unaware that this behavior is contrary to the law and that they have previously been required to pay a compensation amount for similar conduct. If this brings more franchisees forward that have been dealt with in unsavory ways, then so be it. Why should a franchisor be able to get away with these consistent breaches?

Several franchisees, which constitutes a large percentage overall, have lodged complaints with the ACCC regarding misrepresentations and unconscionable conduct however, most of us do not have faith in the ACCC, and that they have adequate resources to investigate all matters such as ours.

Changes to the 2010 amendment are imperative.

**26. Is the current enforcement framework adequate to deal with the conduct in the franchising industry?**

**27. How can compliance with the Franchising Code be improved?**

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

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

After having our joint complaint for more than 6 months, we are yet to see any enforcement action by the ACCC. When a large percentage of franchisees feel deeply about injustices by a franchisor, there must be something that needs the attention of the regulating body. This is evidenced by the fact the ACCC states on their website they cannot pursue all the complaints they receive. There are serious injustices happening right now, have happened in the past, and will keep happening until these issues are resolved. There must be more serious consequences to obvious breaches of the law. In most cases pecuniary penalties are the only option with the desired affect. It should not be discounted just because it may put additional strain on the franchise system. The intended message should be that if you make a serious breach or consistent breaches then you should pay a price for such conduct. Franchisees in the system have shown their confidence and

approval in their management team by the fact they invested all their money in them. Any penalty imposed should have a deterrent effect.

More ACCC representatives are needed for adequate enforcement. At present, the ACCC seldom comes in contact with the franchisee whom has intimate knowledge of his own complaint. If maybe the ACCC representative can interview the complainant or complainants, then he is in the position to decide whether more serious action should be taken against the alleged offenders.

At present, in my experience, the only option to come to a reasonable solution to our dispute is to go to litigation. Litigation is extremely expensive and usually comes after a franchisee has lost all their money trying to make a losing business model work, but which they were told is a profitable business. This results in an extremely low percentage of justice due to the cost factor alone. If cost was not a factor then there would be hundreds if not thousands of franchisees getting the justice they deserve.

The industry desperately needs a low cost alternative that can yield the same or similar results as litigation.

### **Conclusion:**

There is no doubt that powerful lobbying on the part of franchisor groups such as the Franchising Council of Australia has been successful in holding back the introduction of laws that would effectively level the playing field in the franchising sector. Any arguments against change needs to be closely scrutinized and questioned as to what their motivation may be.

Franchisees are generally powerless and do not have an organization to lobby for them and so we rely on members of the government to be our voice and fight for us.

The sensibility of the Australian voter should never be underestimated and their may be an electoral penalty to be paid for inaction.