

# FRANCHISING SOLUTIONS

14<sup>th</sup> February 2013

Mr Alan Wein  
Franchising Code Review Secretariat  
Business Conditions Branch  
Department of Industry, Innovation, Science, Research and Tertiary Education  
GPO Box 9839  
Canberra ACT 2601

Dear Mr Wein,

## **Re: Franchising Code Review – Submission**

Attached please find my submission to your Review.

I have also attached some background about myself. As you will see I have been intimately involved with the Franchising Code since its inception as a Member of the Franchising Policy Committee which drafted the original Code and have over 24 years practical experience in the franchising sector as a franchisor, consultant and mediator.

I have attempted to lay out my submission as per the requested template of questions and areas of query.

I would be pleased to elaborate on any aspects should you see merit in requesting same.

Yours sincerely,

*Tim Hantke*

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Managing Director

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**Submission by Tim Hantke Managing Director of Franchising Solutions 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.**

## Franchise failure

### Discussion questions:

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?

### Response:

In my view it is impossible to eliminate failure in any business enterprise. The current Code provisions are fine.

The challenge is to educate prospective Franchisees e.g. the ACCC sponsored training course established by Griffith University (which is online and cheap) is an excellent imitative.

Prospective franchisees need to learn what a franchise is and what the basic terms mean.

The question of mandating independent professional franchise advice pre sign up is best practice and should be promoted. The issue of practicality for very small investment franchise systems is the issue to be faced. .

Although they receive wide publicity, franchisor failure is not common and often does not mean the end of the franchisee's business. On many occasions the franchisor's business is sold by the liquidator and the business continues. Sometimes franchisees re-brand.

It is also worth considering that some franchise systems fail because of franchisees led issues.

On balance I do not support any further changes but emphasise the need for due diligence and independent professional franchise advice.

Does the sector have any concerns regarding the operation of this requirement

### Response:

No real concerns; it at least causes prospective franchisees to consider the possibility and then seek further advice if required.

## Expenditure and other payments

### Discussion questions:

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? **Response:**

On balance the answer is Yes, despite the increasing compliance for franchisors.

However further refinements should be made so that these items are clearer.

For example, the requirement to disclose **unforeseen capital expenditure** should really focus on disclosure of known future capital investment, e.g. technology and refit/refurbishment costs (which are not unforeseen but franchisee may be unaware of). Need to review reference to “unforeseen”. Should be required to disclose what is known at time.

As an idea perhaps you compare with shopping centre lease obligations re refurbishment.

Need to focus on drawing attention to **fees due in the future**, e.g. renewal fees.

**Marketing fund statements** have insufficient detail. Funds in a marketing fund are essentially held on trust for franchisees and the requirements in the Code are too loose.

Suggest an annual Profit & Loss statement should be required and that there should be a template for such. Should also be required to disclose how much is in the fund bank account (i.e. cash at bank).

Best practice may be to ensure franchisee input in how fund is run however this is not always viable, e.g. small service master franchises. One area of concern is that there is **insufficient disclosure on rebates**. However this needs to be balanced with confidentiality concerns. Best practice is to disclose further details to franchisees but not in disclosure document.

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

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**Response:**

Yes, see above.

**Contract variation, transfer and novation****Discussion questions:**

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?

**Response:**

The issue of reported unilateral variations to franchise agreements seems applicable to motor vehicle dealership agreements and are rarely heard of outside of that sector. Most franchise agreements instead provide that an agreement cannot be amended/varied without both parties written agreement.

That said, sometimes Operations Manuals are used to introduce substantial or substantive changes, e.g. new fees.

Suggest unilateral variations to franchise agreements could be prohibited.

This suggests the need for a definition of "unilateral variation".

The amendments regarding transfer and novation have drawn attention to the question of whether a purchaser can be required to sign a new agreement, i.e. the franchisor's then-current franchise agreement or insist on assignment of the existing one. Many franchisors offer the purchaser a longer term rather than merely receiving the balance of the existing term of the vendor's franchise agreement, so this can be of benefit to the purchaser. This is a positive outcome that is not disclosed in the disclosure document.

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

**Response:**

As above.

## Disclosure regarding franchisor conduct

### Discussion questions:

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?

#### Response:

Definitely an improvement.. The requirement to disclose ex-franchisees' contact details is a good idea and allows prospective franchisees access to useful information.

Some franchisors are circumventing that requirement by encouraging all ex-franchisees to instruct the franchisor not to include their details. This then frustrates the Code's intention that prospective franchisees have access to ex-franchisees. Prospective franchisees should be concerned if no or few ex-franchisees contact details are disclosed (i.e. the number of ex-franchisees does not match the number of ex-franchisees whose details are disclosed) however often prospective franchisees don't understand the significance of this, especially if they do not seek professional franchise advice.

Is the information being provided useful to franchisees?

#### Response:

Yes.

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

#### Response:

Not aware of any effect other than increased compliance.

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

#### Response:

No, other than as above.

## **Disclosure exemption for foreign franchisors**

### **Discussion questions:**

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

#### **Response:**

This was a sensible amendment however the requirement to continue updating the foreign franchisor's disclosure document should only apply if it is a party to the franchise agreement (which it rarely is). This is because Australian master franchisees have had difficulties ensuring that their foreign franchisors are meeting this requirement.

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

#### **Response:**

Only as above.

## **Efficacy of the disclosure amendments as a whole**

### **Discussion questions:**

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

**Response:**

Yes. The information that is included in a disclosure document is important and useful.

However, if any further information is required to be included and the disclosure document increases in length and complexity, the risk is that prospective franchisees will be less likely to read it. That is, it could be counter-productive.

There is no information that is irrelevant and could be removed.

A summary sheet of key terms might be useful.

**The requirement to annex a copy of the franchise agreement in the form in which it is to be executed is unnecessary and impractical.**

The requirement of the Code in this respect is not clear and should be clarified, e.g. if only a small amendment is made to the final franchise agreement, does a new disclosure document need to be issued and another 14 days required to elapse before the final franchise agreement can be signed? The justification for introducing this requirement, i.e. franchisors making changes to the final franchise agreement which did not benefit the franchisee after the disclosure document had been issued and only moments before they were required to sign, was not a regular occurrence or one that most franchisors have even heard of.

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

**Response:**

Generally yes, except for the issue re the form of the franchise agreement in the disclosure document.

However any further requirements will arguably become counter-productive.

**Good faith in franchising****Discussion questions:**

**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?**

**Response:**

The duty to act in good faith is implied in most franchise agreement and most franchisors act in good faith in any event. The amendments to the Code in 2010 had no effect on this.

If an obligation to act in good faith is to be introduced to the Code, then it must apply to franchisees and franchisors.

I have a strong concern that this issue has only been raised, not because franchisors don't act in good faith, but because of the Yum! and Competitive Foods dispute. These questions would not be asked but for this.

The definition that was proposed for WA under the proposed Franchising Act (which again, was introduced because of the Yum! and Competitive Foods dispute) was problematic, e.g. it required parties to act "co-operatively" which is not always possible. This is not what good faith means.

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

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?

**Response:**

It would appear to be ineffective.

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?

**Response:**

As above, I believe the proposed introduction of the good faith obligation originates from the Yum! and Competitive Foods dispute. However, an obligation to act in good faith would not have changed the outcome of this. This was why the proposed WA Franchising Act also included an automatic right of renewal, which would have assisted Competitive Foods. One issue that does not seem to be addressed adequately by the Code or other law is franchisees leaving franchise systems, de-branding their businesses and then using the franchisor's IP to compete with the franchise.

Contractual restraints are commonly understood to be either unenforceable or expensive for franchisors to enforce. This conduct would breach the obligation to act in good faith.

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

**Response:**

No. It should be the same as the current implied common law duty.

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?

**Response:**

It should apply across the board.

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?

**Response:**

The consequences should be the same as for other breaches of the Code. That is, the party in breach should compensate the other party for the loss it has suffered as a result of the breach. The consequence needs to be relative to the breach, that is, if no loss suffered, then it should not be a large penalty.

OR

Financial penalties are required in order to change behaviour. There should also be personal fines for officers of the franchisor.

We must also consider how breaches are decided. That is, if there is a financial penalty, the ACCC may be able to issue infringement notices (which can then be appealed if not agreed). However, if compensation is the appropriate consequence, then this would involve legal proceedings, a trial and a decision by a judge which is far more costly and usually a slower process.

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?

**Response:**

It would not be inconsistent and would apply in addition to the provisions of the Australian Consumer Law.

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?

**Response:**

No. However, if there was a requirement to disclose past breaches, then the disclosure document may need to be amended.

## End of term arrangements for franchise agreements

### Discussion questions:

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?

### Response:

The amendments have drawn the attention of prospective franchisees to what happens at the end of the term, and in some cases, that there is an end to the term! To add to this, it could be useful to include a warning on the front page of the disclosure document and require the franchisee to sign an acknowledgement that they understand.

However, there is little or no evidence of “inappropriate conduct” (such as churning).

The requirement to issue renewal notices could be extended to 12 months before the end of the term, to give time to consider payment of any renewal fee or new fee, any refurbishment obligations and the need to be compliant, etc. This also has benefits for the franchisees as it protects their goodwill.

It would also be useful to address inappropriate conduct by franchisees at the end of term, e.g. not renewing and then de-branding, not complying with restraints etc.

**Compensation at the end of the term is opposed as this would fundamentally change franchising. It would also discourage overseas franchises from having a presence in Australia.**

## Dispute resolution in franchising

### Discussion questions:

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?

**Response:**

No, conduct and behaviour has not changed. The 2010 amendments have not had any effect in this regard.

However, there do appear to be more mediations. Most people attend mediations in good faith and try to get an outcome.

Mediation works well. In many cases, it gets an outcome at a relatively cheap cost (e.g. about \$1,500 per party to pay for the mediator).

The results can depend on the mediator. It is important that the mediator has knowledge of franchising. OFMA are very good and has a successful track record.

Many disputes would not occur if prospective franchisees obtained professional franchise advice prior to entering into their franchise agreement.

Does the sector have concerns regarding the operation of the amendments?

**Response:**

No.

## **Enforcement of the Franchising Code**

### **Discussion questions:**

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

#### **Response:**

No. Non-compliant franchisors need to be fined in order to change behaviour.

Financial penalties are required for clear breaches of the Code but would not be appropriate for more subjective breaches.

Franchisors that establish franchise systems without proper advice deserve to pay financial penalties, e.g. failing to have a disclosure document.

A register of franchise systems could be maintained and details of penalties would be included on this and publicly available. There would however be considerable costs incurred and consideration given to the potential for prospective franchisees to feel that if a system is registered (e.g. with the ACCC) that the system is somehow “approved”.

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

#### **Response:**

As above. There should be penalties for clear breaches.

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

#### **Response:**

As above. There should be penalties for clear breaches.

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

**Response:**

Private litigation however this is expensive.

OFMA to appoint a mediator and the parties attend mediation.

Complaint to the ACCC however the ACCC appears to have extremely limited resources which have caused frustration.

Small Business Commissioner however little franchising experience.

# FRANCHISING SOLUTIONS

*Sharing the Knowledge*

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## COMPANY PROFILE

**Franchising Solutions Pty Ltd** was founded in 2001 to create a professional consultancy to provide skilled and experienced services to the franchising and SME sectors, through the successful formulation and implementation of the Business Plan and the identification, development and optimisation of the franchise system of operation.

Specific assistance is provided to clients in the following ways:-

- Provision of a franchise system **HEALTH CHECK** and identification of development opportunities and strategies to
  - Grow the system
  - Improve profitability – franchisor and franchisees
  - Introduce greater efficiencies
  - Meet compliance requirements
  - Achieve effective franchisor/franchisee relationships
  - Obtain more effective franchisees
  - Gain greater competitiveness
  - Streamline the organisation
- Undertaking **FEASIBILITY STUDIES** into the incorporation of the franchise system model to
  - Determine if the organisation is suited to franchising
  - Determine the costs/benefits of incorporating the franchise system model
  - Identifying the elements of any potential franchise system components
- Assistance with developing the **IMPLEMENTATION** program for a franchise system model to
  - Implement the selected system in shorter time frames
  - Tailor the system to the needs of the organisation
  - Reduce risks associated with the new strategy
  - Achieve higher returns by minimising mistakes
- Conducting individual and group **COACHING / MENTORING** sessions to improve the effectiveness of senior management and key staff.
- Availability as a **GUEST SPEAKER** or **FACILITATOR** at conferences and meetings.
- Assistance in the provision of advice with respect to **DISPUTE RESOLUTION** processes.

**Franchising Solutions is a member of the Franchise Council of Australia.**

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PERSONAL PROFILE

**Tim Hantke**  
**Managing Director**

Tim established **Franchising Solutions** in 2001 to address franchise system needs within organisations.

He has over 35 years experience in management roles within small, medium and large enterprises –

- Bradford Insulation – State Manager WA/Victoria
- CSR Limited – State Manager Sugar Division WA and Corporate Representative
- Universal Waldeck – General Manager –Special Projects
- Snap Printing Group – CEO

Such wide experience across industries and geographic locations has ensured Tim has a broad range of skills to support clients of whatever size and whatever development stage they have reached.

As CEO at Snap Printing for nearly 14 years, he oversaw the development of one of Australia's leading franchises. He led that organisation in franchisee relations, technological change, compliance management, innovation in system establishment and development, brand awareness, overseas expansion, franchisee selection and the achievement of profit by franchisees and the franchisor. These initiatives saw Snap grow to 150 franchised centres in 4 countries and win the Franchisor of the Year Award on 4 occasions.

During that period he served for 7 years as a Board Member of the industry association, the Franchise Council of Australia.

In 1996 Tim was appointed to the **Franchise Policy Council** which was the **Federal Government's Franchising Advisory Committee**. It provided advice to the Government with respect to the introduction of the Franchising Code of Conduct.

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He has a **Commerce Degree** (Accounting Major) from the University of Western Australia and **Fellow Member** of

- **CPA Australia** (former fellow member)
- **Australian Institute of Management** (and Past President of the WA Division)
- **Australian Institute of Company Directors**

Tim's other current appointments include –

- **Board Member - The Living Stone Foundation (Inc) trading as Lifeline WA and former National Board Member Lifeline Australia.**
- **Board Member – Joyce Corporation Ltd (listed public company) / Bedshed Franchising Pty Ltd**
- **Chairman – Co-operative Purchasing Services Ltd**
- **Panel Member (WA) – Office of Mediation Advisor**
- **Panel Member – ACCC Franchise Consultative Committee**
- **Chair TEC 47 and Group Chair WA – The Executive Connection (i.e. CEO's coaching and mentoring organisation)**
- **Member of several Advisory Boards in the public and private sectors**

He has a **National Police Clearance Certificate.**