

# **Review of the Franchising Code of Conduct**

Submission by

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*A walk through any major Australian shopping centre highlights the popularity of franchising. It is easy to believe that any business could be franchised and that the presence of wall to wall franchises illustrates the success of the franchising business model, one that must be revered and something to behold. **This is a myth; nothing could be further from the truth.***

### **Background:**

As a former franchisee of, ‘*Australia’s most successful bakery franchise*’ Bakers Delight holdings. My experience was not a good one. I believe my franchisor abusively interpreted the contract, abused the code of conduct and demonstrated its power to terminate my franchise agreements for engineered and induced breach of contract.

Contracts on my two businesses were terminated on the 27 January 2007. In what the franchisor terms a “hostile takeover”. I lost everything; my life savings, my home and my reputation. Quickly I discovered that my case is not unique within Bakers Delight, and that problems in franchising are widespread, though Bakers Delight holdings does seem to hold the patent. Subsequently, I have been working with franchisees from various networks ever since, seeking proper protection for franchisees.

Collectively, we want to “level the playing field” and remove the disadvantage to franchisees created by an unfair franchising environment. Currently the Franchising Code of Conduct (the Code) does not deliver that and is under review.

### **Code Review:**

Franchisees have been calling on the government to reform the Franchising Code of Conduct for at least the last 30 years. Two state inquiries and one federal inquiry in 2008 found real problems exist within the franchising sector. The Parliamentary Joint Committee on Corporations and Financial services; inquiry into the franchising code of conduct; made 11 recommendations; including the idea of “good faith” and serious monetary penalties for breaches of the Code, in its attempt to combat rogue franchisors. Most of the recommendations were ignored by the then Minister for Small Business, Craig Emerson. Whose attempt at managing the recommendations can be best described as “window

“dressing” A lack of action on his part has delayed the progress of meaningful reform. In the absence of a federal response, franchisees have continued to be collateral damage in a sector out of control, while, franchisors have not been deterred. Rogue operators continue on their trajectory of financial devastation, gouging, bullying franchisees out of their businesses, selling unviable business models and intentionally reselling businesses that have failed 3,4 and 5 times previously.

Consecutive governments have failed to acknowledge the contribution of franchisees to the sector through job creation and most of the investment. Govts seem more interested in the financial welfare of the few fat cats at the top of these pyramids, than providing sufficient protection for the 73,000 franchisees that make significant contribution to the economy.

### **End of term rights:**

***One day a franchisee could ‘own’ a franchise valued at a million dollars, the next they all they have is a cheque ‘buying’ their equipment. Deanne De Leeuw 2008***

Currently franchisees have zero rights should the franchisor decide to terminate the contract. Most franchisees do not understand that the franchisors can and do have the power to terminate for real or induced breaches of contract, or if the franchise agreement comes to an end.

Many franchisees believe that if they have a good “marriage” like relationship with their franchisor they can stay in their chosen system indefinitely and thus benefit from the value of their hard work, and financial commitment. This is not the case. A number of franchise agreements, fail to give franchisees a right of renewal. It appears that this is deliberate and gives unscrupulous and opportunistic franchisors the right to “divorce” their franchisees on a whim and without proving a breach of contract.

Any incentive to work at the relationship is heavily outweighed by the massive cash injection that a franchisor makes when he gets a divorce. The reviewer must consider that franchisors sell businesses not products, it follows that some franchisors run their business on not much more than their key business strategy of buying and selling businesses.

This very profitable exercise, allows the franchisor to work against franchisees, and routinely terminate a percentage of their network at any time during the contract. The potential for a rogue

franchisor to churn all franchisees in his network is very real. The consequences of the franchisor's actions are absolutely catastrophic for franchisees. The franchisee has in many cases mortgaged the family home to raise enough capital to buy into the "proven business model".

At the any time during or at the end of the contract a franchisor can terminate the agreement. Walk into a business lock franchisee out (the writer has experienced firsthand this abuse of power). The franchisor can then open the next day and continue trading with a new franchisee using the good will, a fully stocked business and all the equipment; while the franchisee is left with the debt and a cheque for the written down value(not negotiable) for the equipment. To add further assault the franchisee receives nothing for the good will he has generated over many years.

The solution is straight forward; the code must be amended to recognise the contribution of franchisees in building the franchise, and thus stop the organised robbery of Australian franchisees at the end of the end of contract. The franchisor must be required to buy back the business at fair market value. Essentially this will reduce the opportunistic conduct that has seen too many franchisees lose everything and stop the process of franchise churn in its tracks.

The writer suggests the adoption of fair franchising rights similar to those proposed in California, that provides agreements must be renewed on the same terms as the previous one, and that franchisor must show "good cause" not to renew an agreement.

In addition, non-compete clauses that prevent a franchisee de-badging and trading independently or opening another similar business be removed.

### **GOOD FAITH:**

Franchise contracts are one sided and written to benefit the franchisor. These one sided agreements impose an obligation on franchisees to act in "Good Faith" throughout the relationship; this is not required of the Franchisor. The unequal distribution of power in the relationship has seen the proliferation of franchise abuse with franchisees being the affected party.

The writer has experienced and witnessed numerous examples of franchise opportunism, where the franchisor has not acted in good faith. Mostly related to the unethical abuse of power, the franchisor has issued breach notices for trivial, unreasonable or engineered default. The result is termination of the franchise agreement even if the breach has been rectified.

There are many examples of franchisors not acting in good faith, where a franchisee has been threatened with breach if they do not open the business on a public holiday (Good Friday) or, subject to financial pressure while being forced to carry out expensive shop refits that the business cannot sustain. Franchisees in a number of franchise systems report being threatened with non-renewal if they don't complete refits and when they do complete the refit, the franchisor terminates the contract and takes control of the newly refitted business anyway.

The absence of a statutory obligation to act in "Good Faith" and Goodwill provisions within the Code encourages unscrupulous franchisors to act unethically, while being protected by the contract.

Franchisors know that our regulator has no teeth, and has done a poor job in regulating the sector. There are no penalties for breaches of the code and that they are free to run over the top of franchisees, in other words franchisors do not respect of adhere to the Code.

Associate Professor Frank Zumbo said in submission to the SA Franchising Inquiry that he supports the notion of a statutory duty of good faith, stating:

*The concept of good faith offers considerable potential as a mechanism for promoting ethical business conduct...Such a statutory duty of good faith should operate generally within the franchising relationship, including requiring the parties to resolve disputes in good faith.*

The writer agrees with Professor Zumbo a good and ethical franchisor with nothing to hide will already be acting in good faith, therefore serious penalties for breaches of the Code will not affect these operators.

### **Proposed Californian model:**

The Californian model provides significant protections for franchisees in relation to Good Faith and end of term arrangements:

- A franchisor could only terminate a franchise for "good cause", which would equate to a substantial and material breach after the franchisee is given 60 days written notice to rectify a breach.

- A franchisor would be required to renew a franchise agreement unless the franchisee had a serious breach of contract, and would be required to renew under the same terms as the existing agreement; or if the franchisee elects, under the new terms then being offered to new franchisees.
- All parties to a franchise agreement would be required to act in good faith
- Franchisors would owe a duty of competence to franchisees.

Thank you for the opportunity to submit to this review, the writer is an advocate for fair and equitable franchising in a healthy environment where all stakeholders prosper. It is anticipated that this review will deliver action on franchising that is long overdue, and that it will flood light those franchisors who been operating with impunity for far too long.