

CRAVEABLE BRANDS PTY LTD
ACN 151 143 065

Review of the Franchising Code of Conduct 2023
Submission to the
Department of Treasury

**craveable
brands.**

1 Background

- 1.1 Craveable Brands Pty Ltd (**Craveable Brands**) is an Australian company and is home to four iconic Australian chicken brands, Red Rooster, Chicken Treat, Oporto and Chargrill Charlie's.
- 1.2 Currently the group employs 210 people directly across Australia. Through our franchise network our brands employ a further 13,644 persons across Australia.
- 1.3 With its operational genesis in Perth in the 1970's, Craveable Brands has carved a unique place in the Australian corporate landscape.
- 1.4 The Department of Treasury has appointed Dr Michael Schaper to conduct a review of the Franchising Code of Conduct (**Code**) to consider whether it is fit for purpose and invited submissions from interested parties.
- 1.5 We set out our comments and concerns below noting that our submission may be published.

2 Is the Code Fit For Purpose?

- 2.1 The Code is set to expire in April 2025.
- 2.2 Craveable Brands recognises the importance of the Code and regulating the franchising industry as it inspires confidence in those considering investing in this space. This primary objective is of importance to both Franchisors and Franchisees.
- 2.3 Craveable Brands considers that in general terms the Code is fit for purpose. The underpinning of a statutory obligation to act in good faith, combined with a regime for disclosure and an avenue to resolve disputes in a cost effective manner inspires a degree of confidence to those considering investing in this industry.
- 2.4 Notwithstanding there are always areas to improve and in general terms we consider that the Code has created an administrative burden on businesses that needs to be simplified and that the Code has failed to address legislative changes in certain areas particularly in the Fair Work landscape.

3 Summary of Craveable Brands' Concerns regarding the Code

- 3.1 Craveable Brands has three specific concerns regarding the operation and effectiveness of the Franchising Code following the changes in 2021 and 2022. These relate to:
 - The administrative burden around compliance and the complexity of disclosure;
 - The changes to immediate termination; and
 - The changes to capital expenditure.

4 The Administrative Burden and the Introduction of the Key Facts Sheet

- 4.1 The disclosure of key terms, conditions and other information in a Franchise Agreement is a key element of a successful franchising system. Craveable Brands is concerned that the complexity of the disclosure requirements under the Code invariably leads to extremely lengthy disclosure documents that are not user friendly and is an administrative burden on businesses. This actually serves to defeat the public policy intent of the Code.
- 4.2 By way of example, our current disclosure document for our Red Rooster, Chicken Treat and Oporto Brands is around 300 pages. We consider that the complexity and the length of the disclosure documents actually discourage prospective Franchisees from reviewing the content and recommend the introduction of a risk or summary statement that replaces the Key Fact Sheet and the disclosure statement.
- 4.3 Our view is supported by the ACCC as noted in its submission to the 2013 Franchising Code Review.

In its submission the ACCC stated:

“There is anecdotal evidence (and complaint data) suggesting that many Franchisees do not read, or at least do not understand, the disclosure document they receive before they enter into a Franchise Agreement. This is usually attributed to the length and complexity of most disclosure documents.”¹

- 4.4 The use of a risk or summary statement was supported by the ACCC in its 2013 submission referenced above and was also supported in the “Report to the Hon Fran Bailey Minister for Small Business and Tourism October 2006” by the Franchising Code Review Committee.²
- 4.5 It was also alluded to by the Hon Dr Craig Emerson MP, then Minister for Small Business, when announcing the 2010 amendments to the Code where he asked the franchising sector to deliver a short “Plain English” document for Franchisees setting out their rights and responsibilities.
- 4.6 Whilst it was intended that the introduction of a Key Facts Sheet might simplify disclosure and address the concerns expressed above, the introduction of the Key Facts Sheet has only complicated disclosure because now the Franchisee must read 2 documents and the 2 overlap considerably as the information in the Key Facts Sheet largely duplicates that in the Disclosure Statement.
- 4.7 Some questions contained in the Key Facts Sheet are incapable of succinct answers. By way of example one of the provisions requires a Franchisor to list the amount of ongoing payments a Franchisee must make during the term of a Franchise Agreement. This is incapable of a short answer. As a consequence, invariably Franchisors answer this question by making reference to provisions in their disclosure statement which defeats the intent of the Key Facts Sheet.
- 4.8 In summary, we consider that there was an opportunity missed in simplifying the disclosure process by the introduction of a summary document that would replace the need for both a Key Facts Sheet and a Disclosure Statement.

Recommendation

We recommend consideration be given to simplifying the disclosure process.

5 “Immediate” Termination – the Issues in having to give 7 days prior notice

- 5.1 The Franchising Code currently permits a Franchisor to terminate without the necessity of giving a breach notice (clause 29 of the Franchising Code) in special circumstances including abandonment, endangering public health and safety and where the Franchisee acts fraudulently.
- 5.2 The inclusion of new provisions notably clauses 29 (2), (4) and (5) of the Code are real areas of concern. Essentially, they require the Franchisor to give a Franchisee seven days’ prior notice of its intention to immediately terminate (clause 29 (2)). This period can extend by 28 days if the issue is referred for an ADR process (clause 29 (4)). In those circumstances the Franchisor can only take action to prohibit the Franchisee from operating the franchised business if they have a provision to that effect in the Franchise Agreement (clause 29 (5)).
- 5.3 We consider that these additional requirements (and in particular the requirement to give 7 days notice) add no value – if the Franchisor has taken the decision to immediately terminate for serious breaches such as acting fraudulently, because the Franchisee has committed a serious offence, the Franchisee has abandoned the business or the Franchisee operates the business in a way that endangers public health and safety then the Franchisor is not going to change its decision in 7 days or in the course of the ADR process. As a consequence, the additional time delay adds nothing.
- 5.4 Further it is very unlikely that the Franchisor has erroneously chosen to immediately terminate – either the Franchisee has been convicted of a serious offence or they haven’t, either the Franchisee has voluntarily abandoned the business or they haven’t, either the Franchisee has acted fraudulently or it hasn’t etc. The only category listed that might have some degree of interpretation is whether a Franchisee has operated the business in a way that endangers public health or safety. For these

¹ Australian Competition and Consumer Commission, *ACCC Submission to the 2013 Franchising Code Review* Australia Competition and Consumer Commission, 2013

² Office of Small Business, *Review of the Disclosure Provisions of the Franchising Code of Conduct*, Report to the Hon Fran Bailey MP Minister for Small Business and Tourism, 2006

reasons, we advocate clause 29 (2) and (4) should only apply in those circumstances but in addition clause 29 (5) applies irrespective of whether the Franchise Agreement has a provision excluding the Franchisee from operating the franchised business.

- 5.5 We set out below some practical examples of some of the unintended consequences of these changes:

Practical Example 1

Termination for Endangering Public Health and Safety

Food safety is a critical factor in the restaurant industry given that failures in this area can cause serious illness and, in very extreme cases, can even cause fatalities in vulnerable customers. To address this issue, Franchisors carry out training, coaching and food safety audits in restaurants.

If an operator fails a series of food safety audits and does not respond to extended training and coaching, the Franchisor should be entitled to terminate immediately without giving 7 days' prior notice.

Giving 7 days' notice is not in the public interest for a serious health or safety issue.

If a Franchisee operates a franchised business in a way that endangers public health and safety and the Franchisor gives 7 days' prior notice of termination, but does not have a provision in their Franchise Agreement prohibiting the Franchisee from operating the business then the Franchisee can continue to operate the business in the same reckless manner during those 7 days (or a further 28 days if the matter is referred to an ADR process).

This not only represents a significant risk to customer's health and safety but also to the reputation of all our Franchisees that are doing the right thing.

Practical Example 2

Abandonment

A few years ago (prior to the changes to clause 29) we had a Franchisee abandon 7 stores at once. In reliance on clause 29 we terminated immediately and reopened the stores the next day. If this occurred now we would have to wait at least seven days before we could take over and reopen the stores.

This has considerable repercussions that have not been properly considered namely:

- The employees of the store would be unable to work during this seven-day period (in this example this would have affected around 150 employees).
- Many retail shop leases contain provisions requiring the store to remain open during trading hours and impose liquidated damages on the tenant for each day the store is closed. Typically, this is around \$200 for each hour that the store remains closed. Had the leases in the above example contained such a provision then the landlord would have been entitled to liquidated damages from the Franchisor in the sum of \$117,600 (\$200 per hour x 12 hours per day x 7 days x 7 stores).
- The closure of a store even for a few days has a significant negative effect on the brand's reputation as it causes significant disruption and frustration to our customers and in our experience, this negatively impacts turnover when the store re-opens. The reputational damage to our brand also affects our other Franchisees.

Recommendation

We recommend that changes are made to clause 29 of the Code to address the above issues.

6 “Immediate” Termination – Additional Categories Required

- 6.1 Craveable Brands considers that **the most pressing area for concern with the Code** is the inability to terminate immediately for serious non-compliance with the Fair Work Act and any other relevant legislation relating to employees.
- 6.2 Employees are entitled to expect to be paid at the correct rates and their health, safety and welfare are paramount. This has even more significance in the retailing sector where young workers make up a significant proportion of the work force.
- 6.3 The public and parents of young employees have an expectation that Franchisors act immediately on serious non-compliance with employment laws yet the Code is silent in this regard.
- 6.4 The grounds for termination (without the necessity of issuing a breach notice) set out in clause 29 (1) of the Code have not changed since their inception and as a consequence have not kept up with significant legislative change particularly in the employment sector or public sentiment.
- 6.5 Franchisors must have the right to immediately terminate for serious breaches of employment laws, firstly to protect its workforce and secondly to protect the reputation of the brand (which benefits both Franchisors and those Franchisees that have invested in the brand, the majority of whom do the right thing).
- 6.6 Whilst the Code permits Franchisors to immediately terminate if a Franchisee is convicted of a serious offence, practically speaking this is an unlikely event. Statistics published by the Commonwealth Director of Public Prosecutions indicate that during 2021/22 FY there were only 2 charges laid in respect of the Fair Work Act 2009.³ Since this category cannot be relied upon to immediately terminate, Craveable Brands propose that clause 29 (1) is amended to add additional categories that permit Franchisors to immediately terminate for “serious breaches” of employment laws or for repetitive breaches of employment law. Whilst Craveable Brands recognises that the consequences to a Franchisee following “immediate” termination are serious (in that the Franchisee can lose the entirety of their investment/goodwill) this issue can be offset if the Code introduced a requirement that following the initial sale of the business after termination the sales proceeds were distributed via a waterfall. By way of example the proceeds could be distributed in the following manner:
- Firstly to re-imburse employee underpayments;
 - Secondly to defray the reasonable costs incurred by the Franchisor in terminating and temporarily operating the business;
 - Thirdly towards the franchisee's debtors; and
 - With the balance to be paid to the ex-franchisee.

³ See <https://www.cdpp.gov.au/prosecution-statistics> for verification.)

Practical Example 1

The Wages Inspectorate Victoria is prosecuting Franchisees of several different brands for multiple breaches of the Child Employment Act 2003 including:

- employing children under the age of 15 without a permit;
- failing to ensure children are supervised by someone with a Working with Children Clearance;
- employing children for more hours than they are permitted to work; and
- employing children later than 9pm.

These matters were aired across media platforms including the 7.30 Report. Quotes attributable to Robert Hortle, the Commissioner of Wage Inspectorate Victoria include:

“Victorians will be disappointed to see these household names facing allegations of breaching child employment laws.”

“These are the type of businesses where many kids get their first job, so people rightly expect them to have a strong focus on creating a safe workplace for kids, which is what child employment laws help ensure.”

“Kids under 15 don’t always recognise risks in the workplace and some don’t feel able to speak up when they feel unsafe. Child employment laws help ensure the employer understands the risks and puts measures in place to keep young staff safe.”

Notwithstanding the serious nature of these charges, Franchisors are unable to bring about immediate termination. Instead, they have to follow the process set out in clause 27 of the Code and issue a breach notice despite the serious nature of the charges and the ongoing damage to the reputation and the goodwill of the brands that each Franchisee are associated with.

Recommendation

We recommend that changes are made to clause 29 (1) of the Code to address the above issues to permit Franchisors to terminate for “serious breaches” of employment laws and where there are repetitive breaches of employment laws (which could be accompanied by provisions that set out how the Franchisee would be compensated).

7 The Issues with Capital Expenditure

- 7.1 Clause 30 prohibits a Franchisor from requiring a Franchisee to undertake significant capital expenditure unless:
- (a) it is disclosed in the Disclosure;
 - (b) it is approved by a majority of Franchisees;
 - (c) it is incurred to comply with legislative requirements; or
 - (d) it is agreed.
- 7.2 Clause 30 was amended in 2021 by deleting an additional paragraph (paragraph (e)) that permitted significant capital expenditure if the Franchisor considers it is necessary and justifies it by a written statement setting out the rationale for the investment, the amount required, the anticipated benefits and expected risks.

- 7.3 Whilst capital expenditure is permitted if approved by a majority of Franchisees, the capability and sophistication of Franchisees can vary considerably and as such they may not be able to objectively foresee the investment needed for the brand to remain a modern and competitive QSR business.
- 7.4 Craveable Brands considers the deletion of paragraph (e) is a major impediment to innovation in the franchising sector.

Practical Example

Prior to the recent changes in the Code we undertook a major menu initiative. This required the Franchisee to make a modest outlay to acquire the plant and equipment necessary. This initiative was highly successful. In order to do this throughout our network we could rely on paragraph (e) by sending a written statement to each of our Franchisees.

Following the changes to the Code we would have to have disclosed this as possible capital expenditure.

The notion of including this in a disclosure is simply not practical. At least 2 years prior to this innovation we would not have envisaged this menu initiative so we wouldn't have included it in any disclosure statement and if we included it in subsequent disclosures we couldn't rely on it any way to require existing Franchisees to adopt the project because a written statement was not included in their disclosure.

- 7.5 Franchisors may not envisage the need for a project (meaning they cannot anticipate including it in a disclosure). Following changing market trends they decide to proceed with an initiative, but at that point it is too late to include it in a disclosure statement because this will not bind existing Franchisees as it was not included in their disclosure statement.
- 7.6 Innovation drives franchising networks. Franchisees join franchise networks to take advantage of a Franchisor's systems and innovations – it is counter intuitive if the Franchisor cannot introduce innovative projects without obtaining approval from a majority of Franchisees.

Recommendation

Clause 30 is modified to once again include former paragraph (e) but a cap on expenditure applies if Franchisors seek to rely on that paragraph.

8 Summary

- 8.1 We are supportive of the Code in general terms and consider it is fit for purpose. However, we have real practical concern regarding the complexity of disclosure, termination for special circumstances and capital expenditure.
- 8.2 We trust this commentary assists Dr Michael Schaper in his review of the Code.
- 8.3 Should you require any clarity on the above or wish to discuss it further please do not hesitate to call our Inhouse Legal Counsel, Brett Dingli on [REDACTED] or myself.

Dated the 28th day of September 2023



Signed by
Karen Bozic | Group Chief Executive Officer

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