



## **Submission: Franchising Review**

**Submitter:** Franchise Redress (Authored by Michael Fraser and Maddison Johnstone)

### **About Us**

Franchise Redress was invited to take part in Treasury's Advisory Group regarding the proposed public Disclosure Registry for prospective franchisees. We advocated strongly for increased transparency with the goal of improving franchisor disclosure in the franchise sector following the multitude of scandals we played a significant role in exposing.

### **Franchising Scandals**

We have been in the background for many franchising scandals, given the amount of distress there is in the sector and the amount of franchisees who have contacted us over the years.

Our co-founder Michael Fraser was instrumental in exposing 7-Eleven for rampant wage theft, which resulted in \$170 million being returned to over 4,000 workers, and franchisees were given a bigger slice because many could not earn a living without underpaying staff.

We then exposed Domino's Pizza for "fortressing" and pushing out franchisees who asked too many questions or did not agree to take on additional stores within their territory (which then meant they were often competing with their own brand). Rampant underpayment was also present.

Retail Food Group (Donut King, Brumby's, Michel's Patisserie, Gloria Jeans, Pizza Capers, Crust Pizza, etc) came next, which the ACCC recently settled with the company agreeing to pay \$10 million, which went to franchisees. A class action is ongoing for Michel's Patisserie franchisees. RFG was the catalyst for the franchising inquiry in 2018, given the extent at which franchisees were being sold dreams and expected to undergo costly renovations, further training at their own cost, buy expensive and faulty, expired or moldy goods from the franchisor, and also received no support, all while their stores struggled to make any money.

We should note that we are still contacted by franchisees from all of these major brands to this day. The issues still persist despite regulatory intervention and legislative change.

## The Franchising Code of Conduct

### The Disclosure Register

We advocated for an in-depth Franchise Disclosure Register. In 2021, then Small Business Minister Stuart Robert made it clear in a podcast that it would be mandatory for franchisors to upload their Disclosure Documents to the Disclosure Register. Sometime between this podcast being published and the Treasury Group forming, Disclosure Documents were no longer going to be mandatory.

*“The disclosure register is all about putting in place a single register that potential franchisees can go to. They can see the various disclosure documents, they can see the key documents, the key measures, a range of other information, and we’ll finalise what information is to be on there. **But it is designed that a franchisee will have full knowledge and concurrency of all the franchise systems, all of the disclosure documents**, not to stop competition but to give them as much information as a franchisee can get to choose which franchise system would be best for them.”*

*“For franchisors, there’s not a cost construct but **they will be required to upload their key disclosure documents** and any other document sets that government determines.”<sup>1</sup>*

Stuart Robert

Our fear was that the Register would now be an online franchise-specific version of the Yellow Pages, existing as a space for prospective franchisees to view a catalogue of potential franchises, with no meaningful information. While more information is now required on the Register, Disclosure Documents still are not mandatory, preventing franchisees from being able to conduct important research before being swept up by the buying process. This urgently needs to be changed, as increased disclosure is only a good thing.

It is also concerning to note that not all franchisors are on the Disclosure Register.

### Over Disclosure Myth

There is no such thing as “over disclosure”. Prospective franchisees who reach out to former franchisees listed in the Disclosure Document to understand the culture of the company is a very important step and helps franchisees understand how the franchisor supports, interacts with, and trains franchisees.

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<sup>1</sup> <https://ministers.dese.gov.au/robert/interview-jeff-waters-business-essentials-daily-podcast>

If prospective franchisees decide not to purchase a franchise after speaking with former franchisees, this shows that the process is working as intended.

If franchisors wish to control the way former franchisees speak about them, they can focus on improving their own culture and franchisee profitability instead of focusing on removing their disclosure obligations.

Removing contact information of former franchisees in the Disclosure Document would be a grave misstep that causes franchisees to fall into a company and brand they have not properly researched or understood. The franchise sector claiming that franchisees will not be able to sell their stores if prospective franchisees can contact former franchisees is fear mongering, especially if they are not providing any evidence that this is happening at all, or that former franchisees are providing false information. Going backwards is not the answer given the incredible body of evidence and real-life examples of actual franchisees losing money and being in significant distress through no fault of their own after buying a franchise.

### **Is the Franchising Code fit for purpose?**

Given our unique insights in the franchising space, along with other sectors, we have observed that the current laws, rules and/ or guidelines are often not enough to dissuade companies or individuals from engaging in unlawful or unethical conduct. A big reason is the ability to hide the conduct from the public through confidential mediations, negotiations with regulators, confidentiality clauses in settlements and in some cases, intimidation. This makes it incredibly difficult for prospective franchisees to conduct proper research.

We believe it is important that approaches made by the government to reduce poor behaviour from franchisors must incorporate processes that enable the publication of data that names franchisors that have or are currently behaving improperly.

We are also strong advocates for formally protecting current and former franchisees as whistleblowers. When blowing the whistle on franchisor misconduct, franchisees face possible legal action for breaching their franchise agreement by speaking out, targeted audits, general intimidation, and in some cases surveillance<sup>2</sup>. With dispute resolution processes clouded in secrecy in the franchise sector, the true road to transparency is enabling and encouraging whistleblowing.

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<sup>2</sup> <https://www.smh.com.au/business/companies/cup-of-sorrow-the-brutal-reality-of-australias-franchise-king-20171207-h00lhl.html>

When it comes to mediations, we have observed franchisors abusing this process to their advantage.

1. Punishing franchisees through targeted audits (resulting in breaches) for raising a dispute with the franchisor. A franchisee can lose everything if terminated via the breach process. This creates a huge power imbalance.
2. Using the mediation process with the knowledge that they don't intend to compromise and any aggression or intimidating language they use will all remain confidential. Publicly or to the media, they will say they tried to mediate to appear reasonable, when in reality they acted in poor faith. Mediation also often requires the franchisee to shut their store or put on more staff to cover them, which results in more expensive labour or lost sales. They also have legal and travel fees. The mediation process can be problematic financially for franchisees already struggling, with an imbalance favouring franchisors.
3. Off-book (fake) mediations. No mediation is recorded. Two or three people from head office, one often being the CEO, will meet with the franchisee to 'mediate'. In one that we attended as support people, the CEO of this ASX listed company had gone through the franchisee's social media accounts looking for purchases in an attempt to demonstrate that the franchisee had disposable income and was not living within their means, stressing that the franchise was not unprofitable or the reason for their financial situation.

One source indicated that franchisee dispute mediations were very common in an ASX listed company, yet none of that is made available to shareholders, potential franchisees and the general public. This has helped lead to an increase in the share price and the recruitment of many more unsuspecting franchisees who later end up in financial trouble.

### **How effective are the requirements of the Franchising Code that ensure franchisors make information available to franchisees prior to entry into a franchise agreement?**

These requirements are extremely important. Reducing the amount of disclosure required by franchisors prior to purchasing a franchise would mean franchisees are not able to get proper legal, financial, and business advice prior to making such a significant investment.

## **Lawsuits and Regulator Action**

Requiring the franchisor to disclose all lawsuits they are involved in on the Disclosure Register, the Information Statement, the Key Fact Sheet, and the Disclosure Document is imperative. This is because lawsuits are public information anyway, but can be difficult for prospective franchisees to become aware of. It will help franchisees ascertain whether there is risk for them, if the franchisor has a pattern of suing their franchisees, or vice versa.

After looking at the Donut King and Michel's Patisserie entries on the Disclosure Register, it isn't clearly mentioned that their parent company Retail Food Group had regulatory action against them, and that Michel's Patisserie is currently the subject of a class action. The Key Facts Sheet needs to be downloaded to view this information.

Domino's Pizza is the subject of a wage underpayment class action and has not disclosed this on the register.

## **Pre-entry Advice and Cooling Off**

It is important that cooling off periods remain at 14 days, or be extended further.

Leasing agreements must be disclosed as early as possible given leasing is a contentious issue among franchisees. We have been involved in cases where franchisees cannot even get their franchisor to negotiate on rent, and the franchisee has no power to negotiate given they are not the Lessee. The franchisor has also failed to turn up to lease negotiations, and when the franchisee falls into financial hardship in part due to high rent, the franchisor then sues the franchisee for failing to pay the lease.

These leasing agreements must also include if the franchisor is receiving a kickback or any form of benefit from the landlord. This should include how much it is, whether it is ongoing, and what benefit they intend to provide the franchisee (will they provide cheaper rent until the kickback runs out, etc). We have spoken to landlords who have said a number of franchise chains receive kickbacks for leases. However, franchisees are often none the wiser or have heard rumours but do not have any proof and did not receive any benefit.

Network earnings information is constantly abused by franchisors and should have strict penalties for the provision of misleading figures. The common 'numbers trick' is to leave out a large number of stores from the data or say the data is not available and use a previous better performing year. For example, a franchise network of 700 stores will leave 250 stores out of the data set. These are likely to be the poor performing stores. In small print they will say they didn't have data for 250 stores.

**How well does the Franchising Code support franchisors and franchisees during the term of the franchise agreement? In particular, does the Franchising Code provide adequate minimum standards relating to structural and/or operational change management?**

“Franchisees can request a copy of the franchisor’s updated Disclosure Document each year.”

When talking with franchisees who have requested an updated Disclosure Document from their franchisor, this is often met with great suspicion and they can then be targeted by the franchisor. Instead, we suggest that the Disclosure Document be automatically sent out (not on request) to all franchisees each year given it is important information for them, and that the Disclosure Document be published on the Disclosure Register.

Franchisees should be allowed under the Franchising Code to exit the franchise without penalty should a franchisor significantly change the operating model or management of a franchisor. A clear example of this is Retail Food Group, who purchased a number of already franchised businesses such as Brumby’s, Michel’s Patisserie, and Crust Pizza. Many franchisees said that while things weren’t always perfect under prior management, when RFG purchased the companies, things swiftly changed to the detriment of the franchisee. In their view, the franchise they now had was significantly different to the franchise they purchased but they could not exit the agreement.

We have written on pages 3-4 our concerns with dispute resolution and mediation.

**How effective are 2021 reforms to the Franchising Code which created a process for franchisees to formally request early exit from their franchise agreements?**

We were recently contacted by a franchisee who was sold a franchise that was not making money. This franchisee was told by the franchisor words to the effect of “the last guy ran it into the ground” which is a common marketing ploy by franchisors that suggest the franchise can be profitable if you work hard and are smart.

The franchisee proceeded to buy the franchise and quickly realised that the franchisor provided little to no support, little to no marketing, and the costs were too high. They quickly realised that the last franchisee did not “run it into the ground” but that the store was simply not profitable. This franchisee has become another victim of the “churn and burn” model which was made infamous by Retail Food Group.

What is problematic is that the franchisor will not let the franchisee leave early without paying significant sums, including the franchisor's legal advice and franchise fees. To be clear, this is not a small franchisor. The franchisee's loss over several years will be in excess of \$100,000, not including the expenses the franchisor is requiring the franchisee to pay for an early exit, and our understanding is that the franchisor plans to put the site back on the market.

Despite the new provisions, the franchisee cannot easily exit despite having been a victim of the franchisor's poor conduct and what appears to be the franchisor not acting in good faith.

## **Conclusion**

Previous inquiries have had the benefit of franchisees in distress writing submissions about their experiences in franchise systems. We are concerned that this review will largely have industry groups or what we label 'favourite franchisees' (franchisees who have been incentivised or have an otherwise positive relationship with the franchisor) writing in. We encourage previous submissions to be read as well.

We have also become aware of some in the franchise sector attempting to distort this review by attempting to overrun it with submissions specifically about 'over disclosure', and this has been done by fear mongering current franchisees that they will not be able to sell their store if prospective franchisees can contact former franchisees. We are not aware of any evidence that providing contact details of former franchisees does anything but help inform prospective franchisees.

The reform introduced in 2021 was one step on the way to further regulating fairness in franchising. We advocate for further legislation and regulation of the sector to protect franchisees. We especially encourage the requirement of franchisors to upload full Disclosure Documents to the Disclosure Register.