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Franchising Taskforce

By email only: franchising@employment.gov.au

Dear Taskforce Members

Response to Franchising Regulation Impact Statement

Thank you for the opportunity to provide feedback in response to the Taskforce's Regulation Impact Statement (**RIS**).

Our response to the questions raised in the RIS are set out below:

1. *What are the critical pieces of information that should be contained in a summary document?*

Subway Systems Australia Pty Ltd (**Subway**) as franchisor in Australia considers each prospective franchisee should enter into a franchise agreement based on having undertaken due diligence in conjunction with obtaining independent legal and financial advice.

Subway encourages prospective franchisees to understand the brand, franchisee obligations and the support tools available within the Subway system. Prospective franchisees are encouraged to engage with current and former franchisees to help make an informed decision about joining the Subway system.

While Subway considers providing critical information for prospective franchisees in an easily accessible format is important, we consider the introduction of a mandatory summary document may risk oversimplifying information, at the expense of franchisee scrutiny of the more detailed disclosure information currently required under the Franchising Code of Conduct.

Subway does not provide profit projections and encourages prospective franchisees to undertake comprehensive due diligence with past and present franchisees, as well as seeking independent legal and financial advice. Where a prospective franchisee is looking to purchase an existing restaurant, we encourage the prospective franchisees to have an independent review of the sales and expenses for that business.

Subway considers any prospective franchisee should have access to key information that would impact their business investment decisions. We would recommend, if a summary document is to be introduced, that it be required to include information such as:

- (1) royalty percentage rate paid to the franchisor;
- (2) marketing fund contribution percentage rate;

- (3) any other fees or charges payable to the franchisor under the franchise agreement such as fees associated with a making a franchise transfer request, extension of the franchise agreement or exit fees;
- (4) site location details and lease information relevant to the franchise (perhaps the current site documentation requirement could be merged with the summary document);
- (5) prior operating history of the franchise business at the franchise location (if applicable); and
- (6) summary of the key obligations under the franchise agreement including dispute resolution processes and termination provisions.

2. *If a national franchise register is established, what information should it contain? What would be the benefits and costs of a national franchise register?*

Subway considers any opportunity to increase understanding and engagement with prospective franchisees will likely offer a long-term benefit through better-informed and engaged franchisees. A national franchise register would allow for prospective franchisees to more easily compare franchise systems.

We suggest it should contain limited key overview information such as the following:

- (1) contact details for the franchise sale representative of the franchisor to assist prospective franchisees further with their enquiries;
- (2) general information about the franchisor, for example, name, address and contact number;
- (3) an average capital expenditure investment range required by the franchise;
- (4) operating lifespan of the franchisor within Australia; and
- (5) an overview of the franchisor's business operations i.e. key products and services.

3. *There are a number of existing educational resources on franchising. What additional education options for prospective franchisees should be made available? If there was an online educational resource which brought together the available franchising education options, what would its costs and benefits be?*

Education will always be beneficial to franchisees and Subway considers educated and informed prospective franchisees are best-placed to make decisions about joining a franchise system.

While prospective franchisees currently have access to a wide variety of independent resources to conduct their own research about franchising, a 'one-stop shop' for all educational resources and tools would be beneficial for prospective franchisees. This would allow the franchisor to point any prospective franchisee to this resource to assist them in conducting their own due diligence before entry into a franchise agreement.

4. *What are the practical implications (costs and benefits) for prospective franchisees and franchisors of increasing cooling off or disclosure periods.*

While Subway is committed to ensuring that prospective franchisees enter into a franchise agreement only after careful and informed consideration, in our experience, when a prospective franchisee has decided to join a system they have already committed substantial monies to that plan including obtaining independent advice and working with their accounting and legal advisers to set up specific entities to be involved in the potential operation of the business.

Increasing cooling off and disclosure periods may conflict with other timing periods also in other legislation, for example, leasing contractual obligations. In our view, extending this period will likely increase uncertainty and costs that may ultimately be borne by the franchisee. To lessen the possibility of increased uncertainty and costs, the prospective franchisee should be given an ability to waive the cooling off period having first taken independent legal and financial advice.

5. *How easy is it for franchisors to provide reasonable estimates of leasing costs before they are finalised?*

Providing upfront estimates of leasing costs is not an easy task and is dependent on a number of variables, for example:

- (1) franchisors who do not own the freehold can only provide the prospective franchisee with the latest information as supplied by the landlord or their agent to the franchisor, and keep the prospective franchisee updated with respect to any ongoing negotiations; or
- (2) for greenfield sites, an estimate of costs associated with leasing, such as utility outgoings, may be difficult as those services may not be even connected to the site location at the time the prospective franchisee enters into the franchise agreement and accordingly, an estimated usage cost cannot be obtained or provided.

For these reasons, a franchisor should not be required to provide reasonable estimates of leasing costs which may be outside its control, and a franchisor should not be forced to accept liability of all the financial risk of potential failure.

6. *How often are leasing arrangements finalised after the cooling off period expires? What are the implications of having the cooling off period commence after a lease is finalised?*

Leasing arrangements are frequently finalised after a cooling off period expires and can be frequently occurring during transfer situations. A prospective franchisee may be looking to secure a potential location coming up in the franchise system which is not available at the time the franchise agreement was entered into. For example, a shopping centre development project.

Lease negotiations can take a significant period of time. Providing a prospective franchisee with an extended cooling off period until the negotiations are final may see the franchisor face an extended period of uncertainty and burdensome financial risk.

Having the cooling off period commence after lease negotiations are finalised, places a large amount of risk upon the franchisor who may be required to commit to the site location with a third-party landlord. If the franchisor cannot proceed with the location, it will likely have financial implications and may negatively impact the franchisor's business and reputation with third party landlords.

Where a franchisor signs a head lease and the prospective franchisee then exercises their cooling off right, this may leave the franchisor with a premises, but no franchisee to run the business. These scenarios are particularly relevant to Subway given we do not own any company run franchise restaurant locations. All Subway® restaurants within Australia are individually owned and operated.

7. What would 'meaningful information' look like in terms of marketing fund disclosure?

Subway is committed to achieving transparency of meaningful information with its franchisees.

In our franchise system, we encourage franchisees to have a voice and be collaborative in marketing campaign activities, understanding the costs and benefits for those campaigns.

Meaningful information should be conveyed to prospective franchisees as part of the franchise disclosure document, financials and other reports, and not only within an accounting framework.

Information may also be provided to franchisees in other ways, such as marketing board reports at either national or more local market levels.

Marketing fund disclosure should require provision of details around:

- (1) the overall contributions made by franchisees to the fund;
- (2) breakdown of the percentage or amount spent on national, local market and administration expenses;
- (3) what marketing activities were undertaken;
- (4) the percentage or amount spent on different advertising mediums i.e. television, social media, radio;
- (5) administration costs of the fund; and
- (6) opening and closing balance of the fund.

8. How does the benefit of increased frequency of reporting of marketing funds compare to the costs of increased administration?

Franchisors are already required to provide a copy of their annual audited financial statement for the marketing fund to all franchisees under the Franchising Code of Conduct. In addition, Subway provides more regular updates about marketing expenditure to marketing boards as part of the system.

When good faith exists in the relationship between the franchisor and the franchisees, there is little benefit to increased frequency of reporting as the franchisee has joined the system for the expertise and confidence of the franchisor.

Subway considers the benefit does not outweigh the administrative costs for increased frequency of auditing and reporting as the time and staffing resources needed to do so is at the direct expense of marketing activity, which is designed to drive profitability of franchisees and their businesses.

9. What information should franchisors disclose in relation to supplier rebates? Are there any barriers to providing this?

Our Subway model includes an independent entity responsible for the procurement of equipment, services and goods for the benefit of franchisee members. Commercial arrangements may result in supplier rebates being obtained which are used for the benefit of franchisees.

While our model may be considered unique, Subway considers rebate information to be disclosed by franchisors ought to be limited to the following:

- (1) details of who the rebates are received from and in relation to which product/service; and

- (2) a general overview of how those rebates are applied to the benefit of all franchisees within the system.

There may be practical challenges in providing rebate information, particularly because commercial negotiations with suppliers are usually involve confidentiality terms and conditions. Further, the disclosure risk may impact the willingness of the supplier to provide more competitive pricing.

10. *If franchisors are required to ensure franchisees get a return on their significant capital expenditure, how might this be done in practice?*

In our view, this requirement would be difficult. Increased regulation of significant capital expenditure will raise compliance costs within the franchise system and reduce the flexibility in the franchise business to respond to a change in the business environment.

Subway supports that where a significant capital expenditure is required to be made by franchisees, then we should be able to explain to the franchisee how they can obtain a return on their investment. We consider a franchisor has a responsibility to help franchisees understand how they can best leverage their investment to help achieve that return, for example by purchasing new equipment. Profitability should be the key driver of any investment.

Importantly, a capital expenditure in one business could be very different to a capital expenditure in another because the amount of the operating expenses (such as wages, product costs, equipment costs, rental costs and utility costs) all depend on the characteristics of each business including but not limited to:

- (1) the size of the site/business;
- (2) the location;
- (3) the number of staff the business employs and the basis of their employment;
- (4) the salary the franchisee wants to set for itself; and
- (5) the turnover of the business.

Franchisees as the business owners can have significant direct impact upon the success of the businesses which they have purchased and the ability to obtain a return on that expenditure.

For the above reasons, it should not be left up to the franchisor to ensure that the return is received.

11. *If franchisees are given a right to review capital expenditure business cases (which must be presented to franchisees by the franchisor under clause 30(2)(e) of the Franchising Code for expenditure that the franchisor considers is necessary for capital investment), how would this right be exercised?*

Subway considers achieving the engagement and support of the majority of franchisees for strategic decisions is often critical to success. Subway regularly shares business case summaries with franchisees to help drive participation with required capital expenditure investments.

Transparency of strategic decisions made by a franchisor is important. However, a franchised business is, at its core, the opportunity for franchisees to buy-in to the strategy and business support provided by the franchisor. For this reason, while franchisees should have access to information about decisions, the franchisor and its decisions on how to operate the franchise system, should not be subject to a popular vote process.

12. A number of stakeholders have told the Taskforce that the cost of arbitration can be comparable to going through the court system, and that conciliation may be a preferable alternative alongside mediation. In what circumstances could conciliation be an effective alternative dispute resolution process?

Subway considers conciliation is unlikely to be an effective alternative dispute resolution process where mediation is already part of the Franchising Code of Conduct.

Like mediation, conciliation is also a non-binding process. Arbitration allows the franchisor and the franchisee to receive a determination and a binding ruling at the conclusion of the process, facilitating the parties to resolve and move past the dispute. A successful mediation outcome will also allow the parties to resolve the dispute and move past the dispute.

13. Would you consider including arbitration to resolve disputes in your franchising agreement, if a clear voluntary option were provided?

Within the Subway® system, arbitration is included in our franchise agreement as part of our agreed dispute resolution process with franchisees. Subway would welcome a more cost-effective and simplified arbitration process under the Franchising Code of Conduct to create more certainty of cost for both parties.

14. Under what circumstances should franchisees be allowed a no-fault exit from the franchise system?

Subway considers the only circumstance a franchisee should be allowed a no-fault exit from the franchise agreement should be by consent – a mutual agreed exit beneficial to both the franchisor and the franchisee.

Franchisees have existing remedies available against franchisors where franchisors have not acted in good faith or in accordance with the franchise agreement.

By way of example, the mediation process in the Franchising Code of Conduct is an effective method in which the franchisor and the franchisee can try to resolve matters in a fair and equitable way with the ability to include practical considerations such as the value of the franchised business, financial loans, debt position and personal circumstances which may be affecting the operation of the franchised business as a going concern.

15. If goodwill was required to be fully clarified in the franchise agreement, how might this be done in practice? What would be the costs and benefits of this approach?

Goodwill is often intangible and immeasurable. It fluctuates within the business and is susceptible to market pressures. The franchise agreement can clarify who owns the goodwill i.e. the franchisor of the brand. To define goodwill would increase the potential for disputes to arise within the franchise relationship.

Rather than fully clarifying goodwill, we support increased opportunity for prospective franchisees to seek information on a franchisor's handling of goodwill through pre-entry advice (i.e. independent legal or financial advice) and other educational material. This would assist franchisees without placing an undue regulatory burden upon the franchisor or require additional disclosure documentation

Further Queries

If you have any questions or wish to contact us directly, please do not hesitate to reach out to my team, via [redacted] or phone: [redacted]

Yours sincerely



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