Submission

EXPOSURE DRAFT: Competition and Consumer (Industry Codes - Franchising) Amendment (Fairness in Franchising) Regulations 2020

Who We Are

As a franchising industry stakeholder, Franchise Redress welcomes the opportunity to provide comments on the Exposure Draft.

Franchise Redress was co-founded by Michael Fraser and Maddison Johnstone in 2017 after observing systemic issues in the franchising sector. We have helped to expose multiple franchise brands for corporate misconduct while observing other industry stakeholders turn a blind eye to behaviour that left franchisees and workers financially destitute or exploited.

Background

In 2015, Michael Fraser helped to expose 7-Eleven for an unprofitable franchise model that led to franchisees committing systemic wage fraud. Over $170 million was paid back to over 4,000 workers but unfortunately, much more is suspected to be owed. In the following years, we travelled Australia separately investigating Domino's Pizza and Retail Food Group (Donut King, Gloria Jean's, Michel's Patisserie, Brumby's Bakery, Crust Pizza etc). Franchisees from these companies raised concerns about the profitability of their stores, and that the franchisors were behaving in unethical ways that forced franchisees into financial desperation.

We also helped to expose Mortgage Choice's unfair business and remuneration model that pushed franchisees to cut corners. The patterns became clear: harsh franchise models orchestrated by franchisors lead to franchisees becoming complicit in unethical or illegal conduct for their own financial survival. These are not just "a few bad apples" as industry insists.

Initial Comments

We believe in legislation that is fair and enables healthy competition while not creating an imbalance of power in favour of a particular group. The legal mechanisms must be able to hold wrongdoers to account and enable access to justice or reasonable outcomes for affected parties.

Given our unique insights in the franchising space, along with other industries, we have observed that the 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 though confidential mediations, negotiations with regulators, confidentiality clauses in settlements and in some cases, intimidation.**

That is why 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 badly.

The publication of the data can be helpful in reducing the regulatory burden and cost to the taxpayer. A franchisor being named for bad behaviour by the relevant government department will lead to subsequent media coverage and industry awareness. Potential franchisees will read this and will be less likely to engage with that franchisor, which may have the result of fewer complaints being made to the government in the future. The franchisor would have to improve their conduct to stay in business.

We are also strong advocates for protecting current and former franchisees under The Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019, or including whistleblower protections for franchisees in the Competition and Consumer (Industry Codes - Franchising) Amendment (Fairness in Franchising) Regulations 2020. When blowing the whistle on franchisor misconduct, franchisees face possible legal action for breaching their franchise agreement by speaking out, targeted audits, and general intimidation. With dispute resolution processes clouded in secrecy in the franchise sector, the true road to transparency is enabling and encouraging whistleblowing.

When it comes to mediations we have observed a large ASX listed franchisor abusing this process to their advantage in a number of ways over a period of years.

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, to the media etc., they will say they tried to mediate to appear reasonable, when in reality they acted in poor faith.
3. Off-book (fake) mediatons. 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.

Our source indicated that franchisee dispute mediations were very common in this 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.

Exposure Draft Comments

Schedule 1 - Dispute Resolution

4A: The statistical information relating to disputes needs to include a breakdown of brands so the Minister and the Ombudsman can identify problematic themes emerging before they become systemic or entrap more people in problematic business models. A key example of this would be when the ACCC, over a six-year period, received “61 franchise-related contacts on the Retail Food Group and its franchise brands”, and this still did not trigger an investigation into the company. If the Minister and/or the Ombudsman identifies problematic themes within companies and brands through the statistics provided, further investigations can be done. It would help if this data was published, including brand names.

Division 3

40A (4): the Ombudsman must ensure any ADR practitioner they appoint has **no conflict of interest.** This is particularly the case for ADR practitioners that may moonlight as consultants to, or otherwise receive work from, franchisors or franchise industry groups.

40B: There should be tough penalties for franchisors who discourage franchisees grouping together. Some franchisees have been told by their franchisor that they cannot speak to one another, even though this appears to go against the existing Franchising Code of Conduct.

(1): When franchisees approach the franchisor as a group (2 or more) the franchisor must not make offers to only one franchisee or only make offers to the “louder” franchisees in a bid to weaken the group effort. We are aware that this has happened at various franchise brands where groups approach the franchisor. When approached by a group, a franchisor must deal with the group in its entirety and not offer sweeteners (such as reduced franchise royalties) to a small few in an attempt to silence the larger group. When franchisors make special offerings to one or a few loud unhappy franchisees, we hold particular concerns for franchisees who might have benefited from the greater protection of a group approach, particularly those that have recently migrated to Australia, who do not speak English well, or who have less of an understanding of their rights under the law.

41A - ADR process

(3): Particularly in light of COVID-19, there could be instances where the franchisee is unable to be physically present at the ADR process. In our research, franchisees engaging in mediation or dispute resolution processes (meetings at head office, etc) must either shut their store (often disallowed under their franchise agreement) or spend more on labour to cover the franchisee’s absence. This is particularly difficult where franchisees are struggling with profitability. A possible solution to this could be making attendance at the ADR process mandatory, but enabling virtual appearances. There should always be the option to attend in-person. A virtual appearance would be a last resort. Other solutions would be making sure the ADR process is outside of store trading hours, or not during busy periods.

41C - Costs
(1): Unfortunately we have seen instances of where franchisors, knowing their franchisee is struggling financially, will frustrate the process thus inflating the costs of the dispute resolution process. This is common.

Subdivision D - Confidentiality

44A: Confidentiality is a sore point for franchisees. When franchisors rely on confidentiality requirements, they can resolve as many franchisee disputes as they like while the public and wider franchise network remain none the wiser.

Confidentiality clauses enable misconduct to flourish and silence franchisees who have genuine problems. Systemic issues remain undetected until it's far too late and too many people have succumbed to unviable franchises.

Confidentiality clauses should not always be allowed. Industry will say that prospective franchisees are already able to speak to former and current franchisees. However, our research has indicated that former franchisees are silenced by confidentiality arrangements. How can prospective franchisees ever be properly informed if the franchisor relies on confidentiality arrangements to silence those with genuine problems? One ASX listed franchisor even made a disaffected franchisee sign an agreement upon settlement that they were never to speak of the brand again to anyone.

The Ombudsman should also be notified of systemic issues, multiple instances of mediation, arbitration or ADR, and receive a breakdown of each time a brand or company enters these processes with franchisees.

Each instance of an ADR process should also be recorded in the Disclosure Document, so prospective franchisees aren't blindsided to find widespread discontent within the network.

Schedule 2 - Disclosure before entry into franchising agreements

12. This section should explicitly refer to leasing. If franchisors hold the head lease, it must be a requirement that they inform the franchisee, in writing, whether they received a kickback (or any form of benefit) from the landlord, 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.

16. 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.

Franchisees are often required to provide their figures to the franchisor as stipulated in the Franchise Agreement. Despite the constant “missing data" resulting from franchisees failing to report, we have never heard of breaches being issued to the franchisee. However, franchisors would breach an existing franchisee after questioning the accuracy of the earnings information. The breach may read “cracked tile, mark on wall, cleaning bottle empty”.

Schedule 4 - Capital expenditure

30: Profitability issues - even if in the franchise agreement, franchisors should not be able to impose expensive and costly franchise “refurbishments” (especially where franchisees must use contractors chosen by the franchisor) where the franchisee is financially struggling.

Schedule 7 - Retrospective unilateral variation of franchise agreements by franchisors

Any retrospective unilateral variations of franchise agreements ought to 1) notify all impacted franchisees, 2) lay out in clear layman terms what is proposed to be changed, 3) set a clear date and time at which franchisees must state whether they disagree or agree to the variations, and 4) require at least 51% (majority) of the franchisees consenting to the variation.

This must be a protected process. Networks with ‘favourite franchisees’ (franchisees who are given royalty discounts, discounted stores, loans, or gifts that are not available to other franchisees) - which we have written about extensively - will financially reward their favourite franchisees for consenting to unilateral retrospective changes that could have the ability to harm other franchisees.

Schedule 8 - Leasing of premises

Franchisees must be allowed to renegotiate leases where they sublease or are off-lease. This is to protect franchisees from franchisors who refuse to negotiate with the landlord. This was a common story among Retail Food Group franchisees: the franchisor would ignore meeting requests with Landlords, not turn up to organised meetings, or simply not negotiate on the rent that the franchisee has to pay. Landlords were sometimes sympathetic to the franchisee but were told that their hands were tied. Franchisees should be given notice of meetings between franchisor and the landlord where they are discussing the franchisee’s lease, and be given an option to attend. They should also be given an opportunity to negotiate rent down.

Franchisees should also be told, in writing, any kickbacks the franchisor gets from landlords.

The Franchise Register
The Government recommended a public register of franchisors be introduced to increase transparency in the sector. **This Register cannot be outsourced to industry organisations or companies like FranData.**

We are a strong proponent of the Register being entirely managed by the government and made available on the new franchising website. As far as we understand, there is nothing in the Exposure Draft that mentions the Register, or that requires franchisors to supply their information to the Register when it is up and running.

At Franchise Redress, we see the incredible influence franchisors have over franchise consultants, bodies, groups, and data companies. It is why we have never seen, on an impactful scale, any of the aforementioned groups expose misconduct at the companies from which they get paid. These organisations and companies can be influenced, and may take managing or running the Franchise Register as an opportunity to on-sell their services, memberships, or products.

We hold particularly grave concerns over the Franchise Rating System conducted by FranData. FranData also has a somewhat established Register (The Australian Franchise Registry). They are a privately-run company, endorsed by franchisor lobby group The Franchise Council of Australia. Franchisors are charged by FranData upwards of $1000 to file and maintain their presence on the Register.

Unfortunately, FranData gave Jamaica Blue and Muffin Break a 4 out of 5 Star Rating. Jamaica Blue and Muffin Break stores have been caught by the Fair Work Ombudsman underpaying workers. They were also the subject of strong allegations regarding a brutal franchise model. Finally, they were caught intimidating prospective franchisee witnesses to the Parliamentary Inquiry into the Operation and Effectiveness of the Franchising Code of Conduct. This is all publicly available information, and it is concerning that Jamaica Blue and Muffin Break received such a high rating.

Outsourcing the Franchise Register to the private sector will only hinder attempts to be transparent.