FB2010 Sub 91

West Australian Economics and Industry Standing Committee

Inquiry into the Franchising Bill 2010

Submission from

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Contents:

Background

I thank the West Australian Economics and Industry Standing Committee for this opportunity to submit to this review.

I have been involved in franchising for more than 23 years having been employed by three (3) franchisors and have extensive experience in administration, operations and marketing. I fully endorse ensuring franchisors the ability to protect their investments and the investments of franchisees within their brands.

I was a franchisee for more than 6 years and was forced into bankruptcy by Midas Australia in 2005. By 2008 in West Australia all of the original Midas franchisees had been turned over including many of the finest and acknowledged operators in that network. They suffered substantial financial loss and many suffered severe health issues.

That franchisor was to oversee the turnover of approximately 190 Australian franchisees and mostly in an 84 month period.

I have had firsthand experience with most of the practices mentioned in recent franchising inquiries and I have worked with many other franchisees from many brands that have had similar experiences. I have been involved for 16 years in franchise dispute resolution and for 9 years in conflict strategy development and management.

I am currently employed by a leading national franchisor as a state franchise support manager and continue to absolutely support the franchise business model.

My background includes extensive research over the last nine (9) years into franchising around the world. In that time I and franchisees I associate with have had contact with many hundreds of fearful and outraged franchisees from something like 80 to 100 brands. I have also had contact with a number of franchisors that recognise the problems that detrimentally influence the reputation of franchising and therefore their business.

I am not a lawyer however I deal with the application of good and bad franchising practices where they happen at the small business counter. I have gained an in-depth understanding of the abusive franchisor financial windfalls behind the practices that lead to conflict growth in Australian franchising.

It must be said because it is too often forgotten that the abusive practices and terrible consequences we are dealing with in Australian franchising are common throughout the world.

The issue before the Committee refer to the impact of proposed West Australian franchising legislation and how that legislation and regulation would fit with the current federal legislation.

The recent federal amendments will have a positive influence where instances of typically entrenched rogue franchising brands selected by the Australian Competition and Consumer Commission are pursued.

However, the federal government amendments do not effectively address unacceptable franchising practices in their infancy. Effective deterrents are now on the table in West Australia and South Australia and it appears Queensland may also move to bring franchising under QCAT.

The New South Wales Chamber of Commerce has recommended franchising be brought under a state small business Commissioner and in line with the VCAT model.

The obvious and almost universal appreciation of the franchise business model did not sway any Inquiry Committee away from the reality that there are those franchisors who abuse the model and the inherent contractual power imbalance necessary to allow the model to operate efficiently.

Clearly the goal must be to protect all legitimate stakeholders and the reputation of the franchise business model while making 'cowboy' practices unviable remembering that much of franchising is a '*family affair*' involving married couples and often children and grand-parents.

The Issues before the Committee

Whether there is disruptive influence of the West Australian Franchising Bill 2010 to;

a) Be directly inconsistent with the Trade Practices Act 1974 and the Franchising Code of Conduct, with particular reference to the inclusion of provisions for:

At the outset I would suggest that the WA Bill's exclusion of a right of appeal as a basic principle of natural justice needs review.

> *The right to appeal is limited and deep pockets won't get an appeal heard if it does not meet the criteria. Errors of fact, or the use of discretion in deciding facts, will not usually be sufficient. Having said that, we will have to accept that there will be appeals until a particular issue is clear as a matter of law.*
>
> *I do not believe that appeals will become the standard procedure, as there are other consequences; usually in the form of costs if the appeal is unsuccessful. You don't just 'roll your arm over' in an appeal.*
> Simon Young, Australian specialist franchising solicitor December 2010

As society evolves so must Law but the basics should not be lost.

i. ***the requirement to "act in good faith",***

The Federal Government concluded that a well-defined good-faith obligation was not achievable as law was '*still evolving and there is not a single definition or an agreed, standard set of behaviours that constitute good faith.*'

The Arthur Wishart Act in Canada appears not to have created problems of ambiguity where Section 3 of the *Wishart Act* provides for more than 76,000 franchise contracts and simply states;

Fair dealing:

3.(1) Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.

Right of action:

(2) A party to a franchise agreement has a right of action for damages against another party to the franchise agreement who breaches the duty of fair dealing in the performance or enforcement of the franchise agreement.

Interpretation:

(3) For the purpose of this section, the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

In a recent Canadian Court finding for franchisees in Landsbridge Auto Corp v. Midas Canada Inc. and Quiznos the Court determined

The doctrine of good faith performance imposes a limitation on the exercise of discretion vested in one of the parties to a contract. In describing the nature of that limitation, the courts of this State have held that a party vested with contractual discretion must exercise that discretion reasonably and with proper motive and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.

In Canada, a duty of good faith is codified in the franchise laws of Alberta, New Brunswick, Ontario, and Prince Edward Island.

Outside of Australia there is much case Law relating to good faith and it is clear in findings for and against franchisees that the obligation applies to all parties.

Section 52 of Australia's *Trade Practices Act* requires that a corporation shall not in trade or commerce engage in conduct which is misleading or deceptive or likely to mislead or deceive. Section

52 delivers an obligation of good faith in commercial dealings however good faith in franchising relationships has been vigorously resisted.

Michael Delaney, MTAA, *Transcript of Evidence*, p. 335. Reid Committee **1997**;

> *The other parties who propose that there is not a problem, that nothing needs to be done, the present measures work, are the very same parties who so rigorously and comprehensively opposed Minister Beddall's amendments back in **1992**. The same arguments were trotted out, the same thing. Their purpose in all truth is to deflect and defer and hope another 24 years will go past before anything has to happen.*

The first reference of abusive practices in franchising in Australia's federal parliament occurred in 1976.

Unilateral changes to Franchise Operations Manuals;

In quality franchise systems the universal benefit of franchising's buying power is promoted and delivered where there are many categories of franchisee expenditure that do not come under the influence of supplier rebates.

In many franchise systems it is not unusual for franchisors to negotiate with suppliers where purchasing from 'preferred' suppliers creates a rebate system to enhance franchise advertising funds. And in other franchise systems it is not unusual for franchisors to take part of rebates as franchisor general revenue nevertheless leaving franchisees with a worthwhile franchising benefit.

However, it is the abuse of the contractual power to unilaterally introduce or alter franchise operations manuals that are at the heart of the majority of franchise system complaints. Internationally these practices are acknowledged as systemic in franchising.

No true advocate of the franchising business model would ever argue against the crucial franchising need to modify operations manuals as determined by the relationship between the franchise contract and the contractual obligations to operations manuals that ensure consistency and therefore potential increased investment return for all stakeholders.

The critical functions of operations manuals allow for adaption to business and market needs and to protect and enhance the investment for all stakeholders.

The franchisor profit potential of abusing that contractual power is too attractive for many franchisors around the world. These practices introduce unanticipated revenue streams to the franchisor

to the detriment of the franchisees where franchisees are the only parties to incur the costs associated with doing business.

Any franchisee financial model perceived to be a worthwhile investment during even the most exacting process of due diligence becomes null and void when such abusive practices occur unexpectedly and mid-term to the contract and even worse when these practices escalate.

These franchisors create mandatory purchasing conditions, often repeatedly and mid-term to the contract, negotiated on the basis of the level of franchisor rebate where the entire benefit goes to franchisor's bottom line. The promised network buying power ceases to exist.

The most abusive of these instances, and existing across a substantial number of brands not just in Australia, goes a step further to where the price the franchisee pays for goods and/or services is ultimately inflated to cater to the insisted size of the franchisor's percentage rebate.

The supplier or provider is typically ensuring it achieves a necessary operating margin however, with the added cost of sizable rebates the price to franchisees is pushed higher than that supplier or provider is able to sell identical product or services to independent business operators.

Non-preferred suppliers and providers of equal quality products and services regularly offer substantially lower costs but the threat is that utilizing such suppliers is a breach on the operations manual and therefore the franchise contract.

Some of the other aspects of these practices referred to in complaints in Australia and North America;

- There is no effective regulation of these practices therefore they tend to begin as one instance and often escalate in confidence over time to often cover almost all spending by franchisees.
- Very few franchisees can fund litigation while franchisors have a reasonably accurate understanding of every franchisee's financial strength/weakness.
- The rebate systems within rogue franchises can cover everything from products and ingredients, computer systems, shopfitters, equipment suppliers, vehicles, stationary, uniforms and even aspects of local marketing, finance and insurance.
- These are the systems that have comparatively very high franchisee failure rates where the franchisee financial model is incrementally eroded.

- The franchisees either a) sell to the franchisor that contractually holds first option for a pittance or b) they may have their contract terminated for numerous contrived causes including but not limited to, poor performance or bringing the brand into disrepute when they complain.
- The threat of the financial consequences of termination ensures many franchisees do not complain.
- When franchisees fail many leave a range of traders, service providers and landlords with unrecoverable debt and lost future earnings.
- Franchisee families are affected through generations. Often what was the franchisee life-long effort and legacy is lost in a matter of a few short years.
- Rogue franchisors tend to create relative personal wealth rapidly.
- Rogue franchisors typically utilize franchisor lobbyist affiliated law firms.

Exclusive dealing and third line forcing is administered under s47 of the *Trade Practice Act 1974* and where under s93 a franchisor may apply for an authorization to allow franchisors to insist on network standards by nominating suppliers, providers, product and/or equipment. At times these involve invoicing directly to franchisees by the franchisor 'middle man' to ensure compliance and price management.

The ACCC typically allow such authorizations as s93 merely instructs that the ACCC must determine any public benefit or detriment when considering an application.

Detriment to franchisee parties to the contract has no weight in such authorizations. Franchisees are typically not aware that an application to authorize third line forcing has been submitted until it is authorised and introduced into the operations manual.

There are many franchise systems in Australia where this practice occurs without an authorization Franchisees who understand the known contrived termination or non-renewal consequences of complaint do not complain.

The effect of an explicit obligation to good faith dealings is to ensure better protection of franchising's promoted win/win relationship and addresses the failure of s93 of the TPA to consider abusive franchising practices and franchisee outcomes.

One of the most effective threats utilized by rogue franchisors to shut down legitimate complaints is the threat of non-renewal.

Should such franchisees face non-renewal without just cause they are generally aware in such systems that;

- It is either unlikely they will be able to sell the business or recoup a return to cover debt as the issues that typically bring about this threat relate to legitimate franchisee challenges to unconscionable franchisor profit streams,

- Once they exit the system they will typically face a non-compete clause that may cover a large radius to the franchise business and a time frame of many years. Poolwerx is just one example where the contract clause excludes the operator from participating in that industry to which the franchisee is skilled and for up to 3 years and not within a radius of up to 30 kilometers from the previously contracted territory.

- Franchisee personal assets of a lifetime generally guarantee ongoing loan payments,

- Due to a lack of funding they will not be able to compete in any litigation instigated by the franchisor.

Such franchisees can be left with the debts of the business, without an income and the prospect of losing their home. It is a formidable threat when a franchisor may choose to simply acquire the business for the marked down price of second-hand business assets.

As an example; in the Cheescake Shop franchise this threat now has far greater impetus for those franchisees forced mid-contract to undertake major rebranding finance of between $80,000 and $100,000 if they can obtain such finance. If they cannot they are in breach of their franchise agreement and have already been threatened with termination or non-renewal.

The Cheescake Shop rebranding is questionable on two fronts; a) franchisees report that they are unlikely to ever see a return on that additional investment and average profit levels make such an investment perilous and b), franchisees allege costs are inflated as a franchisor kick-back profit stream and as a means to acquire franchise businesses that cannot comply.

In the case of Jack Cowin's chain of KFC stores the franchisor, Yum International, simply saw the cost/benefit windfall as too attractive to resist and insisted on paying a pittance for the franchisee's investment and years of effort. The franchisee was not in breach of the franchise agreement and had clearly been an asset to the KFC brand.

These are examples in franchising are far from isolated instances where dealings and negotiations are not undertaken in accordance with good faith and fair dealing principles.

The Federal amendment ignored the inherent threats and the practical application of good faith and fair dealing principles while merely introducing additional disclosure reinforcing that franchisees have no redress unless they can fund litigation against the power of the contract and Law.

Although these practices are clearly abusive to the principles of good faith the ACCC will continue to see this as a contractual issue.

Michael Schaper, Deputy Chair of the ACCC at the National Franchising Convention, October 2010;

> *'It must be noted that ACCC cannot take action for breaches of the franchising agreement, because this is a contractual issue between franchisees and franchisors.'*

Dr Elizabeth Crawford Spencer submission [sub39] to the Federal Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct [2008];

> *'Among the many tools available to address the immediate issues facing the franchising sector is an obligation of good faith. It is a tool that provides a low intervention, principles-based constraint to franchisor opportunism, one that is perfectly calibrated to the relational nature of the contract.*
>
> *There are many reasons why good faith may be an appropriate measure in addressing various forms of franchisor opportunism that can arise over the course of the relationship.'*

Good Faith is implied in the Franchising Code of Conduct at 23A and merely states;

> *'Nothing in this code limits any obligation imposed by the common law, applicable in a State or Territory, on the parties to a franchise agreement to act in good faith.'*

The Midas Australia franchise contract offers an insight into the problems dealing with legitimate complaints where there is no explicit obligation for all parties to operate in Good Faith.

Prior to 2000 the contract was promoted as the means to protect all parties to the brand and that was how the contract was interpreted by the then franchisor and promoted to new franchisees. Franchisees had no complaints with the communication of good faith initiatives to enhance all stakeholder businesses.

In mid-2000 with a change of franchisor and under the very same contract it was then interpreted to allow mass introductions of franchisor revenue streams that were to destroy the franchisee financial models while allowing the franchisor the right to withhold advertising fund monies amounting to many millions of dollars over many years. Midas became one of Australia's worst franchising disasters.

However; had a Court reviewed the Midas contract without an obligation to act in good faith I am confident that the Court could not have disagreed with the new franchisor's contractual interpretation. Companies such as Poolwerx have also taken a blanket approach to mandatory rebate systems.

Mr Robert MP (Fadden) - Brisbane Public Franchising Hearing – Oct. 2008

'You could not possibly be indicating that the courts would determine a better definition of good faith than the Parliament, could you? You could not possibly be inferring that we should leave such things for the courts, unelected, to decide as opposed to the nation's elected officials, who are accountable to the people? ...'

'You mentioned Justice Byrne and his judgment, in which he has already begun to define good faith. Therefore there is a good basis for good faith to be inserted into the relevant act without the need to overly define it because the courts have already done so. It simply makes it explicit within the legislation without interfering in the courts - heaven forbid!'

Michael Webster, franchisee attorney, Ontario, Chair of the Strategic Committee for the International Association of Franchisees and Dealers – BlueMauMau Jan. 2011

'Good faith and fair dealing actually mean something in Ontario law'.

ii. civil monetary penalties,

While there is potential within the West Australian Franchising Bill to introduce duplicity in relation to federal/state penalties the reality is that the ACCC process typically targets a different area of franchising abuse to that of the WA Bill and with less capability under the existing Franchising Code of Conduct.

The WA Bill, with monetary penalties, good faith, other deterrents and access to speedy and affordable remedy is an effective package of what will be world's best practice.

The WA Bill will generally influence early stages of abuse and the middle range of disagreements. It is critical to understand the different areas of the market that will be addressed by the WA Bill as opposed to the Code.

Where there is an advantage and the franchisor can point to genuine reasons, matters can be resolved without resorting to expensive, deliberately drawn out adversarial proceedings.

The federal mediation process is only effective when parties voluntarily enter into mediation in good faith. When franchisees to a rogue franchisor understand good faith will not be entertained they avoid mediation.

In creating an affordable and speedy forum to resolve disputes the Bill ensures that abusive practices are firstly reduced by the existence of that forum. Franchisors with intent to abuse will think in terms of good faith and consequences in regard to abusive practices and therefore disputes and regulatory costs will naturally be largely reduced.

The types of disputes to be addressed by the WA Bill are those that can be addressed efficiently in the context of an explicit good faith obligation. These practices or failures by rogue franchisors begin in small incremental testing of potential repercussions and then typically escalate.

This is one area of rogue franchising neglected by the ACCC for reasons including the size of the national problem, as opposed to the state-by-state problem and the absence of federal statutory obligation to good faith dealings.

In relation to duplicity of process and penalties undertaken by both authorities it would be likely that this would occur rarely where I suspect WA would already envisage conceding to the federal process and therefore penalties.

The Queensland Law Society raised this point as calamitous however I suspect a final draft of WA Law would clarify what would occur in such instances where duplicity might occur.

There are thirty-five states in the US with some form of additional franchise Law working in conjunction with the Federal Trade Commission Franchise Rule. The US franchise Rule is somewhat similar to Australia's Code where the focus is in disclosure and ignores effective regulation of the franchising relationship.

Most US states include varying penalties that can be civil and in some instances criminal. Many Australian franchisors should be relieved.

I would suggest that the rate at which Australian federal franchising remedies has historically occurred; the industry could possibly anticipate twenty to thirty years and costing generations of small investor families before federal deterrents address most of the practices detailed in the WA and SA state inquiries and tabled again in the federal inquiry.

The WA Bill can be expected to change practices almost immediately.

The Queensland Law Society rightly states that the Commonwealth Code includes penalties however fails to mention that the penalties historically applied relate to the inconvenience of enforceable undertakings which very often focus on schooling in Code compliance. Financial penalties are hardly a deterrent when those penalties are rarely utilized.

Weakening the WA Bill by removing the financial penalty deterrents does not make sense when there are alternatives to avoiding duplicity of federal/state penalties.

iii. Injunctions,

In the Queensland Law Society [QLS] submission it raises the concern that a franchisee may attempt to utilize both the ACCC and the WA Commissioner to '*simultaneously institute separate proceedings such as to obtain an injunction*'.

As referred to previously and in relation to concerns of duplicity of monetary penalties it may be necessary to further clarify in the WA Bill when WA Commissioner might not pursue a complaint being handled by the ACCC.

I would suggest that effective communication channels between the WA Commissioner and the ACCC would ensure both authorities avoid inefficiency in relation to any area of potential duplicity. After all, the deterrent value in the WA Bill will be reducing the ACCC's potential workload and enhancing franchising's economic contribution.

In some sections of the QLS submission there appears to be a premise that the Commissioner would entertain '*frivolous or vexations*' claims against franchisors causing unrecoverable cost burden to franchisors. I would suggest that such a conclusion will be proven to have no substance.

Franchisees simply have too much to lose where '*frivolous or vexations*' claims have traditionally been the domain of rogue

franchisors. I suspect the Commissioner would have suitable qualifications to determine claims without merit in a decidedly and comparatively inexpensive forum.

Clause 13 of the WA Bill grants in subsection (1) that the Commissioner or any other person may apply to the Supreme Court or the District Court for an injunction against a person to have contravened the Act or endeavoured to do so or to have been an accessory to a contravention.

I suspect that the Supreme Court or the District Court would have the credentials and talent to determine when a claim had substance, when an injunction would meet a reasonable need and when it is appropriate to amend or cancel an injunction.

As with most concerns raised this neglects the financial cost and franchise relational cost facing franchisees where any attempt to pursue an unsustainable complaint would be the exception at best and not the rule.

iv. Redress orders,

In Salah v Timothy Coffees Oct 26 2009 Ontario Supreme Court, Justice Metivier determined in relation to s3 of the Arthur Wishart Act;

> *It is intended to redress the imbalance of power as between franchisor and franchisee. It is also intended to provide a remedy for abuses stemming from this imbalance. An interpretation of the statute which restricts damages to compensatory damages related solely to proven pecuniary losses would fly in the face of this policy initiative.*

The franchisee in this case, Salah, had undergone terrible treatment at the hands of the franchisor and ultimately Winkler C.J.O. awarded an additional $50,000 for stress.

The QLS submission raises concerns in that redress orders within the WA Bill could be utilized to '*compel the renewal of franchise agreements at the end of a term*', and in that context suggests that the six-year statute of limitations creates potential problems.

Clearly the WA Bill will not be delivering to franchisee complainants the power to determine their own findings. In any instance of redress orders in relation to non-renewal the Commissioner will be relying heavily on the principle of just cause and good faith.

No doubt where a franchise non-renewal has resulted in the sale of that franchise to an innocent new franchisee the Commissioner will

rely on redress orders that satisfy the legitimate and just needs of all parties.

The WA Bill offers alternatives to renewal and I suspect there would be instances where the Commissioner would deliver redress where a satisfactory outcome may be an alternative to renewal. But these would be matters for the Commissioner to determine on a case-by-case basis taking into consideration all relevant facts.

In 1397868 Ontario Limited v Nordic Gaming Corp. 5 February 2010, The Ontario Court of Appeal, O'Connor A.C.J.O. sent the matter back to Court concluding in part that there were aspects of the surrounding circumstances of the agreement that could point to an implied perpetual agreement in as much as the franchisee had invested a substantial amount that was unlikely to see a return in the term of the contract.

> *Given that I would order a new trial, I would also remit to that trial the issue of whether the agreement is perpetual or an agreement into which the court should imply a term of reasonable notice for termination.*

The WA Bill is not proposing perpetual agreements or undermining legitimate cause to terminate or not renew a franchise agreement.

The WA Bill is addressing an obvious need for redress where franchisees enter into an agreement, perform to the requirements of the contract and are then simply thrown out whereby the franchisor takes possession of the franchisee's financial equity and goodwill, typically leaving franchisees in debt, and for no other reason than the contract has been interpreted to allow that outcome.

These outcomes have a negative influence on franchising's investor confidence, economic contribution, social costs and are simply unjust.

To gain a redress order in relation to any area of complaint a franchisee is required to substantiate a claim and the level of damage. This process relies heavily on franchisees being able to present to the Commissioner and possibly a Court, a sustainable case.

The intent of redress orders is to produce a solution to counter situations where a common trend in rogue franchising is to destroy the financial ability of the franchisee to present a legitimate complaint. The franchisor historically wins by default.

Cases can be dragged out and can be deliberately delayed for years in order to drain the franchisee so there is no Court opportunity. Typically the process has not taken very long but in the

case of Mark Massie and Deanne de Leeuw v Bakers Delight the process has continued for almost 6 years.

Redress orders address that process and to allow wrongs to be corrected where small investor families often lose everything having been overcome by the financial and contractual power to operate in bad faith.

v. Damages.

The QLS suggests that Clause 13(2) of the Bill should also allow '*a Court to have discretion to determine whether to allow an undertaking as to damages to be sought or given'.*

This does not appear to be an unreasonable suggestion in the context of the entire effect of the WA Bill.

However, where an undertaking is determined as justified I would anticipate that the WA Bill would ensure that Courts have the ability to determine damages in relation to all circumstances and damages and not be determined solely on the basis of pecuniary damages; rather including '*but not limited to property damage, economic loss and physical and psychological harm.*'

b) Enhance the purpose of the Franchising Code of Conduct, which is to regulate the conduct of participants toward each other.

As with the state franchising laws in the United States and aspects of provincial Canadian Laws, the WA Bill is clearly designed to rely on and operate in conjunction with national franchising Law.

The WA Bill addresses the findings from two state inquiries and the federal inquiry. The WA Bill was only brought about because the federal government ignored the majority of recommendations from those inquiries and those Committees considered those recommendations over very lengthy time frames.

The WA Bill produces state based protection for franchisees, ultimately the franchising sector, by dealing with the deficiencies in the Franchising Code of Conduct.

Australia has followed the US example. Richard Solomon, foremost US attorney with over 45 years experience in franchised businesses and a graduate of The Citadel and of The University of Michigan Law School (J.D.-1963) speaking on US federal franchising regulation, November 2010, BlueMauMau;

> *Since the 1960s we have seen enforcement in a coma, with extremely rare exceptions. Where statutes seemed to provide remedies for victimized franchisees, devices were created to*

thwart those remedies - arbitration clauses prohibiting group action; damages limits in the arbitration clauses; contract engineering to change the pitch of the playing field; and appellate constraints on expansive lower court interpretations of franchisee "rights".

Today franchise predation is as rampant as it was in the early 60s. Little has been accomplished other than to provide for "disclosure" that does not enable risk assessment in a meaningful mode.

To truly enhance the Franchising Code of Conduct the federal government should have implemented change in the form of what is now on the table in WA and SA.

c) Result in a cost impact on the State or participants in franchising.

The proposition put forward by the Franchise Council of Australia that state based franchising Law would negatively impact on franchising and cause cost to West Australia is absurd.

The FCA has not put forward any substantive argument on this point because there is none. In the United States and Canada where state and provincial laws exist there has been no suggestion of negative impact.

My extensive background in franchising and particularly my contact with franchisors over many years, suggests that franchisors will operate anywhere there are franchisee investors.

In extending a greater level of franchisee investor confidence combined with the WA Bill's repairing of the sector's reputation, WA can expect an increase in franchising investment.

When franchisees fail there is a negative flow on to families, suppliers, lenders and taxpayers. When franchisees are ensured a fair opportunity to be successful the flow on effect is positive and not just limited to families, suppliers, lenders and taxpayers. Society benefits.

The proposed WA Franchising Legislation has the potential to increase confidence in the sector for existing and prospective franchisees who risk by far the highest level of franchising's capital investment, employs by far the majority of the franchising's workforce and contributes enormously to supplier revenues, local markets and state economies.

Where you have franchisees eager to invest franchisors will continue to invest in and market franchise systems. Any suggestion otherwise is a ruse and a nonsense.

Quality franchisors will have their business positively influenced by an enhanced industry reputation where they will not be jeopardized by Law that targets the unacceptable franchising practices of others.

Those franchisors that comply with the Federal Code will not be affected by any State Legislation other than to have their business recognized as a quality offering.

The only franchisors who will find it necessary to re-write any franchise agreements and/or disclosure documents will be those who are already in breach of the Code.

A continuation of the dangerous investment environment in franchising will ensure that franchising's reputation continues to be undermined by that element of franchisors that do not appreciate the otherwise anticipated high growth of disgruntled franchisees utilizing the internet where all of franchising is tarnished with the same brush.

Quality franchisors cannot be forced to suffer reputational detriment unfairly inflicted upon them by the practices of disreputable franchisors. Franchising's economic influence will maintain healthy growth where there is investor confidence.

Franchise Council of Australia Business Model

Appreciating the business models that exist in franchising associations is important to the context of how the market acts and reacts. Firstly though it is noted that the FCA has not accepted the Terms of Reference set down by the Committee.

The FCA would have the Committee believe that there are no rogues, no rogue behaviour and that franchisees support the cause for no further protection of their interests. Their arguments clearly disagree with the reality that came from three Australian inquiries into franchising.

Australian franchisees need a national voice and that initiative is being investigated in line with the prevailing business models employed around the world and with input from the International Association of Franchisees and Dealers.

The FCA business model is akin to the International Franchise Association business model and somewhat similar to other franchisee and franchisor associations throughout the world.

It is important that Australian lawmakers appreciate what legitimately drives such associations and where their revenue allegiance lies.

The FCA franchisor membership is less than half of the franchisors in Australia and given that it appears to be difficult to be removed from the list of members it is impossible to know how many are active. It is clear that the many of the most highly regarded franchise systems in Australia are not members of the FCA.

The FCA business model relies predominately on revenue from associate and affiliate members just as franchisee associations in North America rely on franchisee friendly product and service suppliers to finance those franchisee representative associations.

These FCA member categories are dominated by legal firms, brokers, consultants and lenders. The association reciprocally gives access to franchising and franchisor markets and would especially not be as effective without the financial revenue coming from its high proportion of legal firm membership.

The FCA lobby group has consistently resisted any change to the legislation and regulation that has maintained the escalating level of conflict in franchising. In the face of world-wide evidence it continues to deny that rogue franchising exists.

FCA resist accurate measurement of the franchising sector's performance as such data would expose the level of damage rogue franchisors cause.

There is virtually no worthwhile volume of franchising case law in Australia where the current environment fostered by the FCA maintains the ability of legal firms to drag out lucrative opportunities under uniform strategy to feed the firm and wait until franchisees can no longer pursue legitimate complaints.

I would also note that the recent tactics employed by the Chairman of the FCA in West Australia were akin with the tactics that saw the Chair reprimanded in the federal inquiry final report, '*Opportunity not Opportunism*', for his part in the attempted intimidation of a Poolwerx franchisee to stop the franchisee's participation in that inquiry. WA, Peter Abetz, South Australia and Tony Piccolo have had a taste of the tactics that FCA will resort to. There is a lot at stake.

Of note; the Poolwerx franchisee was later terminated; forced into Court and now enters bankruptcy. The high prevalence of 'gag' orders in franchising, the threats of termination, non-renewal and litigation are cause for lack of franchisee participation in these inquiries but they are a profitable source of revenue for those who resist fair franchising.

Private Equity Investment and Franchising

ATO changes in 2010 to taxes on asset selloffs by private equity investors offers Australia a level of protection from offshore investors where some firms simply buy cheap, strip assets, create debt and exit.

However, franchising is becoming increasingly attractive to private equity investment firms, offshore and home-grown, where the international concern reflects the abuse of the acknowledged power of franchise contract to extract high level profits above and beyond what is generated from royalty revenue by simply introducing multiple profit streams that attack franchisee profitability through increased mandatory purchasing introductions to operations manuals.

Basically the formula becomes; buy cheap, strip assets, strip franchisees, create debt and exit. A similar approach was attempted by Midas Australia and more recently Allied Brands and while their exits did not go to plan there was substantial damage to franchisee investors and creditors including the ATO.

These are only two examples in Australia and the international list of such firms, particularly from the United States should be a concern. Where these operations abuse franchise contracts they add no value to the Australian economy whether the firms themselves successfully profit or not. They cost Australia.

Of course this is not to suggest that *all* private equity firms behave in such a manner however the WA franchising Bill would not hamper investment where such abusive practices would not be used.

In Conclusion

Around the world generations of franchisees have suffered substantial loss and the personal consequences from rogue franchising.

A new approach to the previously too complex issue of cleaning up franchising can begin in Australia and specifically in the States which recognise that the federal government has failed to acknowledge the efforts and intent from all franchising inquiry Committees.

Entrepreneurs and industry require minimal regulation but they do require effective regulation or they will always attract those that simply take and cost.

> *I do not see that the increased ACCC powers are going to make a significant difference to commercial disputes between franchisors and franchisees. Many of these matters are genuinely outside the scope of the ACCC's mandate. Increasing the ACCC's resources and powers was an answer to one problem, but there is still a need for better dispute resolution, in between mediation and the civil Courts, which is yet to be addressed.*
> Simon Young, Australian specialist franchising solicitor December 2010

The most critical aspects within the proposed Western Australia Franchising Bill that will enhance investor confidence and shut down unacceptable practices are 1) access to affordable and speedy dispute remedy and 2) an explicit obligation for all parties to act in good faith.

Gathering meaningful industry performance data will allow the industry the ability to enhance performance and give prospective stakeholders the opportunity to better invest.

The franchising business model today has been distorted by a growing segment within franchising to where social media cannot be allowed to be the only means by which prospective franchisees are warned of the risks while costing the industry's reputation and optimal growth.

In different sections of this submission I've referred to franchisees with legitimate complaint who deferred to the financial threat of non-renewal or termination. It would seem from all reports that the number is substantial as are the consequences. The WA Bill will negate the threats.

When the West Australian Parliament enacts this Bill it is anticipated that the essentials of Good Faith and Access to Affordable, Speedy Dispute Remedy, ignored in federal amendments, will produce measurable and positive results for future generations of franchisees and the franchising sector in West Australia.

The world is watching West and South Australia and I suspect much of the world of franchising will be influenced to follow suit when healthier industry outcomes are achieved.

Yours faithfully

Ray Borradale
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