BUSINESS MANAGEMENT

When the Franchisor Fails

A research report prepared for CPA Australia
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About the author

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After nearly 20 years as a commercial lawyer in private practice, Jenny Buchan became an academic at the University of New South Wales. Both as a lawyer and as an academic, her focus has been on franchising. This has led to her ongoing research on the challenges that franchising, as a relatively new business model, poses for insolvency law.

(i) Executive summary

- At least 40 franchisors failed in Australia between 1990 and 2005. (Appendix 1)
- Approximately 1090 franchisees and their families were directly affected. (Appendix 2)
- If each franchisee of a failed franchisor had the industry average number of employees, the 40 failures would have affected more than 11,500 employees.
- These failures have indirectly affected landlords, financiers and other suppliers.
- Failed franchisors have been in business for up to 94 years and they have been in franchising for up to 14 years at the time of failure.
- Failed franchisors, and to a greater extent, their franchisees, were extremely difficult to identify. It is not obvious from the public records whether insolvent companies or bankrupts were franchisors or franchisees.
- Franchisees experienced a range of outcomes including taking the opportunity to go it alone, becoming part of another franchise system, financial loss, unemployment, and the associated consequences such as marriage breakdown and relocation.
- As a result of their franchisors' failure, franchisees also had the following experiences:
  - They experienced difficulty in trading when the media were drawing attention to the franchisor's inability to pay its debts even before it became insolvent. Trading was particularly difficult when the franchisee was selling expensive items such as holidays.
  - Franchisees have no automatic statutory right to a voice at a franchisor's creditor's meeting because often they are not creditors.
  - Liquidators owe a duty to creditors to obtain a fair market price for assets and to limit the ongoing liability of the failed entity. That is, theyare not specifically concerned about the outcome for franchisees, so long as terms and prices are acceptable. They are unlikely be concerned about whether the buyer of the franchisor's business will be able to run the franchise system.
- Fluctuations in the franchisee's income after the failure of the franchisor could trigger a tax audit of the franchisee in the following year.
- Speedy and concerted action by franchisees is essential if the franchisor is failing but often they have difficulty in contacting each other except via the franchisor. Sometimes they don't even know each other's surnames. Employees can turn to their unions for support, but franchisees have no support or advice network.
- Franchisees have no way of knowing in advance that the franchisor is about to fail and therefore they have no opportunity to make contingency plans.
- Franchisees are more like employees who have invested money in the franchisor than independent business operators. Despite the franchise agreement stating very clearly that the franchisee is not an employee of the franchisor, it appears that some franchisees regard themselves as employees.
- Most franchise agreements stipulate that franchisee insolvency is an opportunity for the franchisor to terminate the franchise agreement. However, iinsolvency is sometimes defined so broadly in the franchise agreement that the law would not regard it as insolvency. In fact, it is rare for franchise agreements to contain clauses that allow a franchisee to terminate it if the franchisor becomes insolvent.
- International master franchise agreements often include contingency planning for Australian national master franchisor failure.
- The research undertaken for this report shows that there is very little centrally-collected data about the legal aspects of this significant part of the Australian economy.

(ii) Introduction

Purpose

The purpose of this report was to determine the effect of franchisor failure on franchisees. The first task was to identify failed systems. The difficulties experienced in identifying failed systems and the franchisees of those systems are covered in the Methodology section of this report.

Australian law leaves franchisees without specific legal redress if the franchisor fails. However, this is not surprising given that the law is not usually pro-active and that, rather, it responds to demonstrated need. Clearly, the case for specific legal recognition of franchisees in a franchisor failure has not yet been demonstrated in Australia. One of the aims of this report is to stimulate debate as to whether franchisees should be afforded some legal protection in the event of franchisor failure and to ask if whether at least there should be some form of mandatory disclosure to provide franchisees with information about their rights and obligations in this event.

Scope

In this report, franchisor failure is said to occur when an administrator or liquidator is appointed to the franchisor. It does not occur when the franchisor fails as a franchisor; it occurs only when the franchisor becomes externally administered. The term 'franchisor' includes the Australian master franchisee of an overseas franchise system but it does not include a state master franchisee of an Australian system.

Franchisees disappear from the public records when the franchisor's business fails. This makes it very difficult to identify these franchisees and the issues which affect them. This report documents the results of the first empirical research that has been conducted of the effect of franchisor failure in Australia on franchisees.

Appendix 1 is a list of franchisors that were known to have failed between 1990 and 2005. The list is incomplete for the following reasons.

- It includes only franchisors that operated through a corporate structure. Not all franchisors are companies. Even if a franchisor is a company, there are no identifiers in the Australian Securities and Investment Commission (ASIC) records that indicate that a company or a trust is a franchisor.
- If a franchisor is not a company, it may not be registered anywhere on the public record that is searchable. Personal bankruptcy records of franchisors that did not operate under a company structure do not contain identifiers that the trust, partnership or individual was a franchisor.
- In some cases it is the Australian master franchisee (AMF) that has failed, not the overseas franchisor. AMFs have been included as failed franchisors here because the future for their franchisees can be as uncertain as that for franchisees with a local, Australian, franchisor.

(iii) Franchising in Australia

There is significant statistical and market related information available about the Australian franchising sector, which has proved invaluable for this report. Frazer and Weaven report the following facts.

- In 2004, there were about 850 franchisors in Australia.
- There were 50,600 business format franchised units operating (about 42,800 franchisees – some have more than one outlet (question D10 in Frazer and Weaven).
- The average age of the franchise systems was 11 years.
- The average total start-up cost of a new franchised unit (excluding GST) was $120,000 (range $2,500 to $870,000).
- The average number of franchised units in a system was 26 (range was 0 to 3,700).
- The average number of employees per franchised unit was 310 (including permanent full-time, permanent part-time and casual).
- Sixy-nine per cent of franchised systems operated from specific premises; and thus often had lease-related obligations.
- Franchising contributed about 10 per cent of Australia's GDP (source: Franchise Council of Australia).

In 1991, the Federal Government commissioned Franchising Task Force Report (Beddall Report) which made the following recommendations.

Recommendation 1.19

The Bureau of Statistics should be required to collect on an annual basis at least the following statistical information in relation to franchising in Australia:

- Number of outlets that have ceased trading (among other things).

The Beddall Report thus acknowledged the dearth of statistical information then available on which to base future policy initiatives. However, even if Recommendation 1.19, with its focus on franchisee failure, had been implemented by the Bureau of Statistics, data about the identity of failed franchisors would not be available in an easily accessible format. The Beddall Report made reference to the then known causes of franchisor and franchisee failure in Chapter 2. In paragraph 2.9 it dismissed the need for attention to be given to franchisor failure by saying:

2.9 Franchisees are clearly vulnerable to the collapse of the franchisor. However even when the franchisor has collapsed, some franchisees are capable of surviving as independently owned and operated outlets, as with a number of the Barbara's House and Garden Franchisees. With appropriate restructuring arrangements, virtually all LJ Hooker Real Estate franchisees survived.

Although the statements in paragraph 2.9 of the Beddall Report are correct, they gloss over situations where franchisees have not fared as well as those identified. Ultimately, the solutions proposed by the Beddall Report were intended to reduce franchisee failure rates.

The need for mandatory pre-franchise disclosure was addressed by the amendment to the Trade Practices Act 1974 (Commonwealth) in 1998 which made a breach of the Franchising Code of Conduct 1998 (FCC) a breach of the Act.. At the same time, the need for legislative recognition of unconscionable conduct in business to business transactions was addressed with the enactment of section 51AC of the Act.

The franchise model is generally proven and successful. However, two widely adopted assumptions about franchising are that:

- the franchise business model is fully evolved, and
- franchisors do not start franchising until they have a proven business.

Franchise accountants, business bankers and insolvency practitioners will be aware that neither assumption is justifiable in all cases.

The increase in the overall number of franchisors from 693 franchise systems in the 1998 Franchising Australia survey to 850 franchise systems in 2004 masks the fact that not all the original number re-appear in 2004. Those that disappear have not necessarily failed as a business. Some franchisors re-purchase franchised outlets from franchisees after deciding to move away from the franchise model. Some simply stop delivering support to the franchisees but do not fail as companies, only as franchisors.

The image of franchising has been scarred by several widely publicised franchisor collapses, particularly those of the Cut Price Deli franchisor in 1995 and Traveland in 2001.

The Cut Price Deli system seemed to drown in a sea of litigation arising from breaches of the consumer protection provisions of the Trade Practices Act. Its collapse was particularly damaging because the system included 150 franchisees occupying prominent retail sites and it had been in franchising for about 11 years.

The experience of Traveland demonstrated that public companies and franchisors can fail. In 2001, the publicly listed Australian company, Ansett Airlines, the official airline to the Sydney 2000 Olympic Games, became insolvent with direct repercussions for its 35 subsidiaries, including the franchisor, Traveland Pty Ltd. At the time of the collapse, Traveland Pty Ltd was operating about 100 company owned travel agencies and employing about 750 staff. In addition, there were about 270 franchisee owned travel agencies trading as 'Traveland.' Administrators were appointed to Traveland Pty Ltd in 2001. The failure was nothing to do with Traveland itself, but was a result of the parent company's insolvency.

Union, public, financier, media, and ultimately government support, was generated for the former employees of Ansett (and, by implication, the employees of its subsidiaries) (see Appendix 3). Consequently the employees of Ansett and Traveland were accorded some dignity and comfort by the clear legal status they enjoyed in insolvency. However, things were different for the franchisees. Insolvency law does not accord any unique status to them.

This research project arose from speculation about the fate of the Traveland franchisees. Despite widespread media coverage of the Traveland collapse, little or no mention was made of the plight of its franchisees, despite the fact that they constituted 73 per cent of its travel agencies.

Without data, the extent of franchisor failure and the effect of franchisor failure on the image of franchising as a trusted business model and on franchisees, banks, landlords and other stakeholders can only be the subject of educated guesswork.

(iv) Theories and models

The lack of information on franchisor failure in the annual survey of franchising and other sources of information available to those who are thinking of buying a franchise does little to encourage lawyers to insert amendments related to the possibility of franchisor insolvency. Even if amendments were sought, franchisees are usually signing a standard contract; therefore amendments that contemplate franchisor failure are unlikely to be acceptable to the franchisor.

The franchisee's situation does not fit comfortably within the insolvency regime. The franchisee has a vital, vested interest in the outcome of the insolvency yet it has no legal right to influence the outcome. In theory, insolvency would give all legitimate stakeholders a right to have their legitimate interests taken into account by the trustee in bankruptcy or the liquidator. When insolvency involves a franchise system the insolvency model locates a key stakeholder, the franchisees, in the wrong place in the insolvency model; the franchisees are an 'asset' or a 'liability' and, as such, have no rights.

Theories

Contract law

The relationships between all players in the franchise system are governed by contracts. These include franchise agreements, leases, licences, supplier agreements, finance agreements, employment contracts and any other documents recording matters between franchisors (and their related entities) and franchisees and, if the franchisee is a company, its directors. In principle, these contracts are made between independent parties and are negotiable.

However, '... franchising is problematic for contract law' (Hadfield p 929). The traditional view of contracts is that the contract records the parties' negotiated agreement. The parties are presumed to have considered all important issues and provided for them. In the absence of bad faith (for which the franchisee may have contractual remedies), unconscionable conduct or misleading or deceptive conduct by the franchisor (for which the franchisee can turn to legislated solutions), the express terms of the contract will govern the relationship between franchisor and franchisee.

Where there is a power imbalance between parties, as with franchisors and prospective franchisees, none of the current common law or legislated legal approaches to redressing the overt power imbalance, "'satisfactorily strikes at the heart of the problem: the incompleteness of the contracts that structure such a complex relationship, one which requires high levels of commitment to protect large sunk investments against opportunism' (Hadfield p 929).

The necessarily incomplete relational contract (franchise agreement) implicitly acknowledges that there will be issues that arise during the course of the franchise relationship that have not been considered. The franchisee believes they will be addressed when they arise and they often are. Some incomplete contracts provide a procedure for resolution of unknowns; others address them as and when they arise. Potential failure of the franchisor is, arguably, not an unknown, and should be provided for by specific provisions or a procedure being included in the contract.

In addition to governing the relationship between franchisor and franchisee, the contract governs the relationship between the administrator or liquidator and the franchisee. Specific statutory provisions override the contract. In the case of the franchise relationship, the Corporations Act and the Bankruptcy Act allow the liquidator to disclaim onerous contracts. This includes franchise agreements, leases, supplier contracts, and other contracts that affect the existence and viability of the franchisees' businesses.

The consumer protection provisions of the Trade Practices Act (Parts IVA, IVB and V), and the requirement for compliance with the Franchising Code of Conduct help to level the playing field in the pre-purchase phase and during the period of the franchise where the franchisor is still solvent. They are no help to the franchisee of a failed franchisor.

Franchising theory

Franchising should only be embarked upon by successful businesses. The myth that franchisors do not fail has been perpetuated in Australian annual surveys of franchising which describe growth in number of franchise systems in successive years without referring to the number of exits. By way of contrast, the NatWest 2004 United Kingdom Franchise Survey provides a more balanced picture of franchising in the UK to the careful reader by observing (p 6):

> The net increase in the number of franchise systems (to an estimated 695 in 2004) masks the fact that as always there have been a number of withdrawals as well as additions. During the year, we have identified 63 systems that withdrew from franchising, that is nine per cent of the systems recorded a year earlier. … Many of the withdrawals and additions are not the result of commercial failure or new business start-ups. Much of the 'churn' seen in the industry is the result of companies deciding to discontinue franchising as a means of expansion, or companies new to franchising conducting trials to test its viability. The criteria we use for inclusion are also extremely strict, so each year some companies are no longer considered appropriate for inclusion. Many brand names may therefore continue to trade successfully (most likely with company-owned outlets), but are no longer judged to be actively involved in franchising.

This notion of a proven, and by implication infallible, business model, is perpetuated by the Franchise Council of Australia. In his message introducing the July/August 2005 edition of *Franchising Magazine* the chairman of the Franchise Council of Australia (Stephen Giles) cites as a reason for the current high level of credibility of the franchising model of business development in Australia (p 12):

3. Australia has a regulatory framework that provides strong protection to franchisees.

Giles's comments would be accurate if he had said that Australia has a regulatory framework that aims to provide strong protection to franchisees. The statement in its current form arguably gives intending franchisees the impression that the law has addressed all gaps in the model. When it comes to the issue of franchisor insolvency, this is not the case.

Insolvency law

Creditors are paid out in insolvency according to priorities. Some have security for the money owed them and are entitled to sell the security to recover the debt. Entitlements due to employees are given special treatment in insolvency legislation. The reason generally put forward for prioritising debts due to employees is that employees are particularly vulnerable if their employer becomes bankrupt or is wound up. The priority was introduced into insolvency legislation for social welfare reasons 'to ease the financial hardship caused to a relatively poor and defenceless section of the community by the insolvency of their employer'. (Law Reform Commission General Insolvency Inquiry, 1988, para 722, quoting the Cork report, para 1428)

However, 'the principal rationale for the employee priority has been significantly diminished by the development of a sophisticated social welfare system. Further, the effect of the priority is to deprive other unsecured creditors of their claim to a share of the available assets. Included in that class of unsecured creditors may be small traders who were substantially dependent upon the insolvent for their business and persons who were in an employee-like relationship with the insolvent but who are classified (in a strict legal sense) as independent contractors. There, creditors may be as vulnerable as employees in the event of bankruptcy or liquidation but enjoy no protection' (Law Reform Commission General Insolvency Inquiry, 1988; Para 723).

Franchisees are included in this class of unsecured creditors, having, as they do, an employee-like relationship with the insolvent franchisor. Under the current law, they typically have no specific legal rights that a liquidator would be required to recognise. They must rely on contractual rights.

Models

The three relevant models for this report are the relational contract (including the notion of privity of contract), the franchise model and the insolvency model.

The relational contract model

The relational contract model is arguably the contract model that best explains the legal basis of the franchise relationship. A relational contract attempts to document and provide for a 'continuing process between people whose interests include maintaining business relations' (Williamson, quoted by Seddon and Ellinghaus, p 1124). 'Two firms that are intimately bound up with each other because of the nature of their business will tend to behave in a less strictly contractual way' than they would do if they had a choice of firms to contract with' (Seddon and Ellinghaus p 1126). This is true of franchising where the franchisor and the franchisee are bound together by the franchise. The franchisor must, however, retain flexibility to experiment and develop the business.

The weakness in franchise agreements (contracts) is that they contemplate and provide for the failure of the franchisee but, almost without exception, are silent about the possible failure of the franchisor. Franchise agreements between a franchisor and an Australian national master franchisor (AMF) often do contemplate the failure of the AMF. As is appropriate in a well drafted relational contract, a mechanism is provided for the franchisor to require franchisees to sign up with a newly appointed AMF.

A further challenge for contract law is the doctrine of privity of contract. As a general rule, only the parties to a contract can sue for breach of a contract. Some franchisors operate through several legal entities, each having a different role. As soon as the franchisor conducts the franchise system through more than one entity, the franchisee is disadvantaged because the doctrine of privity of contract only gives the franchisee the power to sue the entity with which it has a contractual relationship.

The franchise model

In its simplest form, a franchise relationship is between a franchisor and a franchisee. It is governed by a franchise agreement. Both franchisor and franchisee have numerous other contract-based commitments such as leases, finance arrangements, stock supply contracts, computer software licenses, the franchise operating manuals and employment contracts with their respective employees.

With very few exceptions, franchisors in Australian have to comply with the Franchising Code of Conduct (FCC). The FCC (the Schedule to the Trade Practices (Industry Codes – Franchising) Regulations 1998) is federal legislation. A franchisor is defined as follows in section 4:

'franchisor includes the following:

(a) a person who grants a franchise;

(b) a person who otherwise participates in a franchise as a franchisor;

(c) a sub franchisor in its relationship with a sub franchisee;

(d) a master franchisee in a master franchise system;

(e) a master franchisee in its relationship with a franchisee'.

'Although the franchise relationship may appear unremarkable on the surface, it has in fact a highly distinctive structure. Unlike either an employment relation or an ordinary independent contractual relation, the franchise relationship is characterised by the fact that franchisees own the bulk of the capital assets of the franchise and franchisors retain the right to determine how franchisees will use those assets' (Hadfield, p 991). This situation poses challenges for several areas of the law including insolvency. The significance is that the franchisor has used its superior negotiating power to place the franchisee in a position where, through no fault of the franchisee, the franchisee's capital assets are vulnerable.

The franchise model can be extended by the inclusion of the following:

• national franchisees where a franchise system operates in more than one country,

• master franchisees, and

• area developers.

The franchisor must make a disclosure to the franchisees. However, the franchisor is often merely one of an interconnected web of legal entities. The franchise system often comprises several discrete, but related businesses. The other related entities may have an effect on the solvency of the franchisor. They could be, for instance:

• a parent company of a wholly owned franchisor;

• Franchisor Franchising Pty Ltd (a private, limited liability company) that will be the franchisor' on the franchise agreements;

• the shares in Franchisor Franchising Pty Ltd may be owned by companies, individuals or trusts;

• Franchisor IP Pty Ltd may own the intellectual property, and will grant licenses to the franchisor, giving it the right to grant licences to franchisees;

• Franchisor Properties (NSW/SA/ WA etc) Pty Ltd may hold the head lease on the franchisees' premises;

• Franchisor Construction Pty Ltd may be the supplier of shop designs and fit–outs;

• Franchisor Supplies Pty Ltd supplies stock to the franchisees; and

• Franchisor Finance Pty Ltd may supply finance to franchisees.

All companies may be owned by the same individuals. Where the franchise business is owned by a public company (9% of franchisors in Australia are public companies, Frazer and Weaven) it is likely that there will be a public limited company, of which Franchisor Franchising Pty Ltd and all of the other businesses mentioned above will be wholly owned subsidiaries. The situation is complex and it changes from system to system and across industry sectors. While a franchisor may think of all the interconnected entities as "'the franchise', the law interprets the franchise as a number of discrete legal entities, each with its own creditors, debtors, assets and liabilities.

Only the franchisor and a related party that owns intellectual property rights relevant to the franchise have to make disclosure of current solvency to intending franchisees in order to comply with the Franchising Code of Conduct. Any review of the law would need to consider whether it would be desirable for franchisees to receive disclosure of the names and function of all players in the franchisor's related entities.

The insolvency model

Corporate and personal insolvency are both regulated at federal level. The basic model for each regime is the same although each has different policy objectives. Personal insolvency is regulated by the Bankruptcy Act 1966 (Cth), corporate insolvency by the Corporations Act 2001 (Cth).

The general purpose of bankruptcy law is to provide a protective and ordered process in the event of financial distress; to facilitate the equal access by creditors to a debtor's property in order to compensate them for their loss; and to allow individuals who find themselves in financial difficulties to be given a fresh start, freed from the financial obligations that were the subject of the bankruptcy (Keay and Murray).

The general policy objective of the insolvency provisions in the Corporations Act is to allow for the orderly winding up and ultimate deregistration of insolvent companies. The basic components of the legislative corporate insolvency scheme are:

- If a corporation cannot pay its debts as and when they fall due (that is, the corporation is insolvent), (Corporations Act 2001 (Cth), s 95A) an application may be made to the court to appoint a liquidator. The application may be made by a creditor, the corporation, a director or member of the corporation, ASIC or a liquidator (Corporations Act 2001 (Cth), s 459P).
- Once the liquidation has commenced, the directors no longer manage the affairs of the corporation: the liquidator manages them. The liquidator is the only person empowered to dispose of company property. A corporation in liquidation is given some protection - creditors cannot enforce any judgements or orders they may have obtained (Corporations Act 2001 (Cth), s 468(4) and 500(1)); and other legal proceedings may not be brought or pursued against the corporation without the leave of the court (Corporations Act 2001 (Cth), s 471B and 500(2)). This includes franchisees who have obtained judgements in their favour.
- The assets of the corporation are realised and the proceeds distributed by the liquidator proportionately to those creditors who are able to prove debts in the corporate insolvency.
- Once the creditors have been paid, the surplus assets of the corporation (if any) are distributed to its members, also on a proportional basis (Keay and Murray).

Unless a franchisee is a creditor, there is no room in the insolvency regime for it to have a voice in the franchisor's insolvency, far less a share of the insolvent's estate.

(v) Methodology

In order to identify franchisees, the following public records and databases were searched electronically.

- media reports, using the Factiva database;
- Australian Securities and Investments Commission (ASIC) – administrators and liquidators file documents surrounding corporate insolvency at ASIC. www.asic.gov.au;
- insolvency and Trustee Society of Australia (ISTA) – trustees in bankruptcy file documents surrounding personal insolvency at ITSA;
- Australian Competition and Consumer Commission (ACCC) – initiates investigations and prosecutions for breaches of the Code. www.accc.gov.au;
- state and territory business name records; and
- federal, state and territory court records using the www.austlii.edu.au and Casebase databases.

Media reports were a valuable starting point. In most cases a failed franchisor was identified in a media report by its trading name. Where the trading name and the legal identity of the franchisor were similar, it was possible to find the legal identity of the franchisor (eg The Furniture Wizard Pty Ltd traded as Furniture Wizard). However, in cases there was no relationship between the identity and the trading name (eg Chaste Corporation Pty Ltd traded as TRIMit), it was very difficult to find the identity of the franchisor. After creating an initial database of possibly insolvent franchise systems, ASIC records were then checked to verify the actual status of each corporate franchisor and copies of insolvency related records were purchased to determine whether franchisees could be identified from the records filed with ASIC and, if so, how they were categorised.

Identifying former franchisees of failed systems

The most difficult challenge in the project was identifying and finding current contact details for individual former franchisees. Only franchisor records contain complete records of franchisees. Following a system failure, the administrator or liquidator would have compiled a list of franchisees but there is no requirement to file the list with ASIC or ITSA. Without access to these records, it was impossible to ascertain if all of the franchisees had been identified.

There are few court cases involving franchise failures, thus searches of court records yielded little information. The exception was the Synergy in Business system which was prosecuted successfully by the ACCC. The reported case ACCC v Ewing [2004] FCA 5, lists the names of 31 franchisees.

Where business names had been registered to satisfy state and territory business names requirements, extracts of the relevant registration were purchased. Although the registration had generally lapsed, the contact details of the former franchisee were still on the records. However, they are often not current.

As one of the failed systems was a travel agency (Traveland), an advertisement was run on the daily electronic newsletter that circulates to the travel industry. This elicited three responses from former Traveland franchisees.

Advertisements specifically aimed at former franchisees of failed franchisors were placed in a number of national and state daily newspapers including The Australian and the Daily Telegraph. It was an expensive exercise and the response rate was very low (see Appendix 4). Specific advertisements were not placed in Tasmania, the Northern Territory or Western Australia because of the relatively low number of franchisees in those states. A press release sent to one daily newspaper was picked up and used.

Qualifying franchisees

Searching state and territory business names registers proved to be the best way of identifying former franchisees. Only 87 franchisees from 14 failed systems were ultimately identified by name through the public records and it was not possible to locate many of these.

Surveys were sent to former franchisees who agreed to participate. Two survey instruments were used. The first was tailored for Traveland (46 questions) due to the high proportion of Traveland respondents whose identity was known and the second (45 questions) was generic. Completed surveys were returned by 14 former franchisees. This low response rate means that the survey responses are not statistically valid, therefore this research is of limited significance.

Because franchisees were difficult to track down, letters were also sent to administrators and liquidators of specific systems where their identity was known. In all cases, these professionals provided valuable information.

(vi) Research challenges

The main challenge here was the range and complexity of the legal ownership structure of the franchises and those of the relevant public records.

Franchisees are often private companies, with contractual obligations supported by the personal guarantees of the directors. The franchisors, as is seen below, are also primarily companies (Frazer and Weaven 2004 Question D18).

AUSTRALIAN FRANCHISORS USING ENTITY %	LEGAL ENTITY	REGISTER ENTITY	FILE INSOLVENCY RECORDS
64.6	private company	ASIC	ASIC
9	public company	ASIC	ASIC
9	trust	ATO/ASIC if corporate trustee/ ?	depends on ID of trustees
6.9	sole ownership	ATO	ITSA
6.9	partnership	ATO/ ?	ITSA as individuals
3.5	other	?	?

Distinguishing franchised businesses from non-franchised businesseses

Some businesses do not knowingly establish themselves as a franchise and only realise that they are operating as a franchise after court action. For instance, Synergy in Business became insolvent on 6 June 2002. Proceedings were commenced by the ACCC on 22 July 2002. In Australian Competition and Consumer Commission v Ewing [2004] FCA 5 (28 January 2004), the ACCC successfully alleged that the licensor was in fact franchising and had breached the FCC. These breaches gave the franchisees rights under the Trade Practices Act. The 31 franchisees had signed licence agreements and had not known they were franchisees until 18 months after the franchisor failed.

Finding former franchisees

As indicated, finding former franchisees was a major challenge. The Synergy in Business case, Australian Competition and Consumer Commission v Ewing [2004] FCA 5 named the 31 licence holders but did not state their addresses or even the states where the franchisees operated.

ASIC records

Where the franchisor is a public company, (for example the failed Ansett and Carlovers) there is no requirement to report the identity of the franchisees in the company's annual return. While franchisees are treated as an asset or a liability by a liquidator, they have no identity as individuals.

Liquidators lodge the prescribed paperwork with ASIC or ITSA. The lists of sundry debtors and unsecured creditors contain names and addresses of people and companies that owe and are owed money by the failing company, but give no indication of the nature of the debt or the claim. Therefore it is difficult to distinguish which debtors and creditors (if any) are franchisees.

A franchisee may be characterised as a sundry debtor or a creditor, depending on the structure of the franchise. In many cases franchisees are not mentioned in the material filed by the liquidator.

Details must be cross referenced to court reports, media releases or a business name extract to determine their status. Employees' claims, by contrast, are identified in a separate schedule – schedule E to the report of affairs filed by the liquidator.

Business names register

Businesses that do not trade under their company name or their personal name are required by state or territory law to register their business name in the state or territory in which they operate. However many businesses ignore this legal requirement. For example, in the failed system No Regrets (with 600 franchisees) which became insolvent in 2002, there are only two registered business names – one in New South Wales and one in Western Australia. Therefore there are 598 former franchisees that cannot be identified through the public records. In The Furniture Wizard (with 35 franchisees) only 21 have registered business names.

Once a business name has been registered in compliance with state legislation, it is added to the centralised, federal, ASIC website (http://www.asic.gov.au/asic/asic.nsf) The site typically provides information such as the following that was extracted from ASIC's database at 11:07:32 on 16/03/2005. The Furniture Wizard Pty Ltd is an insolvent company that was deregistered in 1999.

The information generated by the search (below), states that there is 'no document list available for this organisation type'. This implies that there is no further information available about the business.

Name	Furniture Wizard – Wangara
Registered state/no	WA 0217638D
Type	Business names
Registration date	Unknown
NextrReview date	Unknown
Status	Deregistered
Principal place of business	Not available
Jurisdiction	Department of Consumer & Employment Protection, Western Australia
No document list available for this organisation type	

In fact, an inquiry at the Western Australian Fair Trading Office reveals that historical information about the business named Furniture Wizard – Wangara is available. Sometimes this historical information contains the name and residential address details of the former franchisee.

The human dimension

A further challenge to research on franchisees of failed franchisors is that many former franchisees' lives have been disrupted by the loss of their business. Former franchisees were not always willing to participate in a survey.

Litigation records

The lack of reported court cases about franchising also limited attempts to discover information about the inner workings of franchise systems from court records. The Franchising Code of Conduct mandates mediation as the compulsory method of attempting to resolve franchise disputes before proceeding to litigation. As mediation is a process of confidential dispute resolution, no system specific details are published.

In addition, anecdotal evidence from the Franchisees Association of Australia indicates that many franchisees choose not to become involved in litigation against their franchisor, even when they feel they have a strong case, because they fear that if the franchisor's business is negatively affected their own business will be similarly affected.

Interpreting information on franchisors' websites

After hearing that the Australian master franchisor for Kernel's Amazing Popcorn was insolvent, the system website was checked. The website indicates a franchise system that is in good health, one that a prospective franchisee may be attracted to. It does not identify the franchisor. The only legal entity named is Jatora Pty Ltd which has the role of 'negotiating and holding the head lease on all its locations'.

A search of the ASIC company and business name records name had a different outcome with 17 business names registered incorporating 'Kernel's Popcorn' but no company names. The Australian master franchisor is not called Kernels. The ASIC search reveals that Jatora Pty Ltd is 'under external administration and/or controller appointed'. The administrator was appointed on 18 March 2005. A resolution that the company be wound up was recorded by ASIC on 21 April 2005. It is unclear from publicly available information prior to the company's failure, whether Jatora plays any other role other than head tenant in the leases. However, the liquidators' report to creditors filed with ASIC compliant with s 239A of the Corporations Act shows that Jatora was the Australian master franchisor.

The Kernel's situation highlights three very real challenges for franchisors, potential and existing franchisees and administrators and liquidators.

- Ideally, both the franchisor's and the franchisee's businesses can trade on until a buyer for the franchisor is found. However, both franchisor and franchisee can be affected by the insolvency, particularly where customers are required to pre-pay significant sums of money for services or goods such as for travel or furniture. It is easy to see that the franchisee's business may suffer a downturn if customers become aware of the franchisor's insolvency.
- In Kernel's case, the website discloses that the franchisor 'holds the head lease on all its locations'. It has about 20 sites, mainly in shopping centres. Usually a lease will declare that the tenant has committed a breach of its lease if an administrator is appointed. This could give a landlord an opportunity to terminate the lease, leaving the franchisee without premises unless they renegotiated directly with the landlord. Former Kernel's Popcorn franchisee, James Rixon is reported as saying that 'when Kernel's failed he started a new company with other franchisees and they will trade under a new franchise brand. Rixon says it was fortunate that he had a good relationship with his landlord and he was able to negotiate a new deal' (*Business Review Weekly*).
- A further complication in this case is that the franchisor is actually an Australian master franchisee of a Canadian franchise system. It is common for such agreements to list the appointment of an administrator as an event that would give the international franchisor the right to terminate the agreement with the local master, and to 'cherry pick' amongst the franchisees, with no obligation to take over all franchise agreements.

Challenges for franchisees when the franchisor fails

Often, franchisees' only point of connection with each other is via the franchisor. They may not know each other's names or addresses. If the franchisor collapses, franchisees can lose their only means of getting in touch with each other. This problem is not overcome by the current wording of the disclosure the franchisor makes to comply with the Franchising Code of Conduct (see clause 6.2 and 6.3 FCC below). The franchisor is required to supply business contact details (but not the name of the franchisee) for some or all franchisees in the system at the time the franchisee obtains the disclosure. If the result of the failure is that the franchisee loses its business address and phone number, the link is severed.

6. Existing franchises

6.2 For each existing franchisee:

(a) business address, if this is not the franchisee's residential address; and

(b) business phone number; and

(c) year when the franchisee started operating the franchised business.

6.3 However, if there are more than 50 franchises, the franchisor may instead give details under item 6.2 for all franchisees in the state, region or metropolitan area in which the franchise is to be operated.

Individual franchisees cannot see signs of failure because they see only one part of the picture. An employee, however, may have received their pay late or received other signs of the impending failure of their employer such as rumours from within the business or from suppliers.

Nor would lenders to individual franchisees be able to see any signs of failure, even if the franchisor and the franchisee were both customers of the same bank.

- They would operate different sized accounts and be dealt with by different sections of the bank.
- They would most likely be in different geographic locations.
- The business names of the franchisee and the franchisor would be different so there may be no trigger that connects them. This is unlike identifying employees of a failing company (for instance former Ansett or Traveland employees) who will often be receiving regular deposits of pay from their employer by direct credit and can be identified fairly easily by checking common information.

The creditors who may be in the best position to distinguish franchise system failure from individual franchisee failure may be the managers and owners of large city and suburban shopping centres where the franchisees are tenants. However, they are unlikely to compare information frequently with other shopping centre owners.

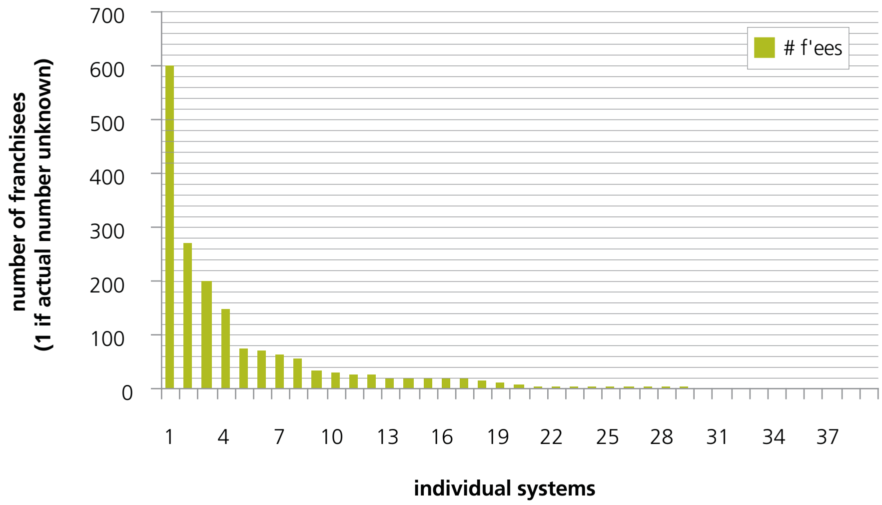
Australian franchise agreements do not generally provide rights to franchisees in the event of the franchisor's failure. Of 36 franchise and state master franchise agreements, only one New South Wales master franchise agreement makes any provision for franchisor insolvency. In this environment, it may be unreasonable to expect liquidators to think of franchisees other than as assets for sale, contractual liabilities to be disclaimed, or as debtors or creditors.

Franchisees use a wide range of local advisers, not necessarily big accounting or legal firms. The big firms, traditionally acting for franchisors, may have dealt with franchisor failure, but local advisers may never have dealt with individual franchisees affected by a franchisor's failure. While the franchisor's accounting and legal advisers have access to the complete picture, an individual franchisee of a failing franchisor may only have access to information supplied by the media, other franchisees or the liquidator. This information is unlikely to assist them to make a fully informed decision about the future of their business.

In many large and well established franchises, franchisees are represented by the system's franchise advisory councils while the franchise is trading but once the franchisor gets into financial difficulty many franchisees become fully focused on the plight of their own businesses. A small or new system is less likely to have a franchise advisory council. The franchisees in any system are likely to be scattered over a wide geographical area.

While it is only possible to estimate the number of franchisees affected by franchisor insolvency, a review of the data sources suggest that more than 1090 franchisees have experienced their franchisor's business failing (Appendix 2).[1]

Number of franchisees in systems when franchisor failed



The media reports of the widely publicised Traveland failure variously reported the system as having between 265 and 285 franchisees at the time the franchisor failed. The lack of reliable data stems from:

- the fact of the uniform appearance of franchisor owned and franchisee owned outlets, whether it be the physical outlet or the entry in a white pages or other directory;
- the inconsistent status of franchisees in the administration or liquidation (all are notionally assets but some are actually liabilities; a few are creditors and many are likely to be debtors);
- the fact that franchisees are not required to be listed in the documents that must be filed to comply with the Corporations Act or the Bankruptcy Act when a franchisor's business fails;
- the fact that the only accurate information is in the franchisor's records, and this information is confidential;
- the fact that some franchisees have more than one franchised outlet. In the Traveland situation, some franchisees had three or four travel agencies, each trading under a separate franchise agreement.

1 NOTE: where the minimum number of franchisees is not known, 'one (1)' has been entered for the purposes of creating the chart below. A '?' has been entered instead of one (1) in Appendix 2.

Failed franchisors do not fall into specific industry categories, nor does the age of the system or the number of years the franchisor has been trading or franchising seem to be a defining factor in future success. The table in Appendix 2 and the graph below illustrate this.

Of the 15 industry categories used by Frazer and Weaven, the identified failed franchisors fell into seven. They were spread across personal services, business services, retail food, retail non-food, wholesaling, transport and 'other'.

The retail food and retail non-food based businesses require retail premises and varying amounts of fit out; the personal services and business services franchises required relatively little capital investment. The respondents to the survey conducted to support this report, however, mainly purchased low entry cost franchises which did not require expensive fitouts

If the franchisor's business is in a pre-liquidation stage and is being run by an administrator, the administrator will consider all options. If there is a chance of the franchisor trading out of the financial trouble or a buyer being found for the franchisor's business, the administrator and the franchisor's creditors may let the franchisor continue trading, and thus retain its market share, while a buyer is sought. This is what happened with Ansett and Traveland. While it is a desirable strategy for the creditors, it does make for uncertain times for franchisees. The challenge this strategy can impose on franchisees is shown by Traveland's post insolvency story.

Case study: Traveland

The insolvency of the Traveland franchisor is described as a tragedy in four acts by Trevor Sykes (Sykes). He recounts;

> Act I. 24 September 2001 '… saw the parent company, Ansett's administrators sell Traveland to a dot.com company that had not previously been involved in the travel industry, Internova Travel for $500,000. At this stage Traveland had 104 branches and 750 staff. Internova Travel (incorporated specifically for the Traveland purchase) bought the money-losing business with borrowed money, without tying down its potential partners and financiers.'
>
> Act II. 28 September 2001 saw the Australian Investment Corporation of Western Samoa (AIC) buy half of Internova Travel for $500,000. In this Act,
>
> 'the half a million AIC put up seems to have disappeared straight down the insatiable maw of Traveland in wages and other costs.'
>
> Act III. 8 October 2001, Financial Options Group Inc (FOGI), a company owned by the two Sydney entrepreneurs who controlled AIC, paid $2million for the balance of Traveland. Possession of the business passed on 8 October but settlement was not required until 24 October. The money was not paid and on 26 November 2001 Internova Travel's directors put it into administration, which quickly turned into liquidation. The Australian Securities and Investment Commission put FOGI into liquidation on 18 February 2002.
>
> Act, IV. was performed on 23 December 2001. FOGI's liquidator sold Traveland to Travelworld for $250,000. Travelworld now has all Traveland's staff and licenses. Sykes concludes: 'Finally, Traveland was vanishing like the Cheshire cat.'

Throughout the drama recounted by Sykes, there is little mention of the estimated 270 to 285 Traveland franchisees. There is no mention of the franchisees in the Ansett court cases relating to the insolvency (Ansett cases). The Traveland business, including the logo, was an asset in the Ansett insolvency. The Traveland Franchise Council was of the view that franchisees did not have grounds for terminating franchise agreements. This was a view shared by a Melbourne QC who was consulted by one of the franchisees:

> 'We'd just renewed the franchise agreements on our 4 outlets for 5 years when the franchisor's administrator was appointed. We went to see a QC to see if we could get out of the agreements and there was no way.'

According to a former franchisee, the purchasers of Traveland knew nothing about travel or franchising, and eventually they failed as franchisors. Once it became obvious to the franchisees that the new owners of the Traveland brand did not have the expertise to run a franchised chain of travel agents, the franchisees moved in several directions:

- Twenty franchisees switched to UTAG travel.
- Several franchisees switched to Harvey World Travel.
- One hundred and fifty Traveland franchisees joined Travelworld (International Franchise Association News 01/02/02).
- One franchisee surveyed for this report became an employee of another agency, having lost so much that hecould not continue as a franchisee.
- At least three franchisees re-branded as independent travel agents.
- The fate of the approximately 100 other former Traveland franchisees is unknown.

It should be noted that a liquidator does not appear to have an obligation to sell assets of the failed franchisor to the purchaser who would be the most suitable from the franchisees' perspective, nor even to a purchaser who is well motivated towards the franchisees. Theoretically, there is nothing to stop a liquidator selling the franchisor's business to a direct competitor of the franchisor. That direct competitor may elect not to buy the franchise agreements but, instead, to simply buy the brand and shelve it.

What happens to franchisees' assets and liabilities when the franchisor fails?

When the franchisor fails, the franchisee encounters a situation not provided for in the franchise agreement which is likely to take them by surprise. Franchisees of failing franchisors sought assistance from a range of advisers when their franchisor failed. The 14 former franchisees who responded, claimed to have sought advice from multiple sources, including:

- accountant (7)
- administrator (3)
- liquidator or Provisional Liquidator(10)
- tax agent (1)
- banker (1)
- local solicitor (4)
- liquidation lawyer (1)
- franchise lawyer (5)
- franchisor (3)
- franchisor's employees (not franchisee) (3)
- other franchisees (10)
- purchaser of franchisor's business (1)

The accounting profession (accountants, administrators and liquidators or provisional liquidators) has the greatest opportunity to help franchisees of failed franchisors because many businesses have an ongoing discourse with their accountant, and the accounting profession takes the lead role in administration and insolvency in Australia. In some countries, the lead role in insolvency is taken by lawyers.

This also suggests that some of the sampled franchisees initially consulted fellow franchisees. This was an opportunity for them to work together to have a say in the liquidation.

It was surprising that so few franchisees in the sample consulted their banker. Perhaps this was because the survey sample consisted mainly of franchisees that had funded their entry into the business without borrowing. However, in situations where a large capital investment was funded by debt, you would expect that more franchisees would consult their banker.

Franchisees experienced the following business consequences as a result of the franchisor's failure. None of the sample became bankrupt or insolvent themselves.

- I re-branded as a franchisee of another system and kept trading (5)
- I became an independent business person in the same business and premises (2)
- I had to close my business (5)
- I lost money (13)
- I did not continue to trade when my franchisor became insolvent – I became an employee of another travel agency (1)
- I did not continue to trade when my franchisor became insolvent – I left the area of business my franchise was in (5)
- I did not continue to trade when my franchisor became insolvent – I became unemployed (3)

The FCC does not contemplate franchisors' insolvency, and only provides for the right for the franchisor to terminate the franchisee's agreement in the circumstances described in clause 23 below:

23 Termination – special circumstances

A franchisor does not have to comply with clause 21 or 22 (ie give franchisee a proscribed amount of notice) if the franchisee:

(a) no longer holds a licence that the franchisee must hold to carry on the franchised business; or

(b) becomes bankrupt, insolvent under administration or an externally-administered body corporate; or, etc

Gillian Hadfield noted, in her 1990 analysis that 100 per cent of US franchise agreements contain clauses which give the franchisor the right to terminate for specified grounds, including bankruptcy in 79 per cent of cases. In her very detailed analysis of franchise rights and obligations, she made no mention of clauses that gave comparable rights to franchisees.

Given that a franchisee seldom has the right to terminate the agreement if the franchisor fails, it is relevant to ask what effect the franchisor's failure has on the franchisee.

Franchisees' comments on the effect of franchisor failure

Some comments made by survey participants about the effect of the insolvency on their franchise business or other aspects of franchising include:

'I lost a lot of money, reputation and health.'

'I think that the emotional turmoil and lack of assistance from government, associations and lawyers (due to fear of repercussion) left us weaker and more vulnerable, which has resulted in many owners selling up or becoming ill from exhaustion – trying to rescue their business. This event had major impact on staff sick days too.'

'Very unhappy with how the whole issue was handled by Traveland, their lawyers and buyers.'

'The former Traveland franchisees who were still running travel agencies had to collect the travel tax levy that the government imposed on all travellers to help fund claims by Ansett employees. This rubbed salt in the wound.´

'"Because of the great discrepancy in income from the years of being a franchisee to the year following the insolvency, the Australian Taxation Office had audited our (the former franchisee's) tax.'

'Most business clients did not use me once the franchisor went into administration.' (Restoration and repair service)

'I believe my story is a fairly common one. Had my franchisor put the time, money, resources into developing our franchise, as promised, and as we franchisees certainly all were, our businesses were going to be very profitable indeed. Instead (possibly due to greed and haste) the franchisor attempted to take all our intellectual property, research and development, systems and techniques, contact details, client details, etc to establish a new franchise to operate in direct competition to ours. This resulted in much conflict and friction between franchisees and franchisor, threats of legal action, etc. A number of franchisees bonded together to seek legal advice... to protect ourselves, our businesses and our futures. Through a very messy string of events the franchisor went into liquidation. A number of ex-franchisees continued business under a co-op or collaborative agreement. Unfortunately I did not have the funds (this franchisee lost more than $75,000 because of the franchisor insolvency) nor the strength or heart to be part of this. Those that continued in business (in the same sector) are still operating today! '

'People would walk into the shopping centre and see my Traveland sign. I would then hear them say, "That's the one that failed isn't it.'

Franchising is often likened to a marriage. As with matrimonial property, a franchisee's assets originate from two sources – those owned prior to franchising and franchise related assets. Before buying the franchise business, a franchisee often owns assets as an individual. On buying into a franchise system, they acquire assets in the business. The franchisee may use secure the purchase of the franchise business with personal assets such as real estate, thus putting those assets at risk. While the need to use real estate as security for debt is a commercial reality, there seems to be some imbalance if the franchisee loses assets due to the franchisor's failure.

Franchisee's personal assets

The franchisee's assets usually consist of real property, personal property such as vehicles, cash in the bank or shares in public companies. If the franchisee is a husband and wife team, or siblings, the assets may be owned by more than one individual. Where a franchisee uses personal loans or guarantees from family members, these can be at risk. The franchisees in the survey used their assets as security to fund the purchase of the franchise. Five respondents had secured their borrowings with mortgages over their homes.

In the 2004 Franchising Australia Survey, 29 per cent of the franchisor respondents reported that they provided finance to franchisees. The most popular methods were direct finance supplied by the franchisor (59%) and finance from third parties – usually companies related to the franchisor (39%). Sixty-four per cent of franchisors offering financing required a personal guarantee from the franchisees' directors, a charge over the item's finances (48%), or security in the form of a mortgage over the franchisee's real estate (29%) (Frazer and Weaven B2, B3, B4).

In the United Kingdom, three in five franchisees borrow money when starting up their business, the need for specific business premises being a significant driver of borrowing. Those who required specific premises for their operation needed an average of £54,500, compared to the £14,000 among those not needing specific premises. Retail banks provide finance to 85 per cent of borrowers. Other providers include relatives and friends (11%) and the franchisor (1%) (United Kingdom Franchise Survey p 37).

Assets acquired on becoming a franchisee

The major asset of the franchisee is the right to operate the franchise business. This contractual right is granted by the franchisor. In addition there is usually stock and plant (including vehicles for mobile franchises and for car rental franchises), employees and goodwill. The specific assets in the business obviously vary with the type of franchise. Specific contractual rights and liabilities will determine the fate of each asset if the franchisor fails. Whereas a lender cross-collateralises loans, it is not commercially realistic to make each of the franchisees' contracts with its many suppliers and employees contingent on the franchisor's solvency. The franchisor is assumed to be the solid base on which the franchisees build their businesses. Some assets continue to have value even if the right to trade as a franchisee is no longer available. Others quickly become a liability. For many, the outcome cannot be predicted.

(viii) Goodwill

In legal terms there are three types of goodwill: business goodwill, site goodwill and personal goodwill. The franchisee pays for business goodwill and possibly site goodwill when buying into a franchise system. Personal goodwill is added by the franchisee. A component of goodwill is usually taken into account when the franchise fee is calculated. In 2004, the average franchise fee in Australian franchises was $35,000 ($40,000 for retail franchises) (Frazer and Weaven, A6). Former franchisees who responded to this survey paid franchise fees of up to $60,000, but on average less than $35,000 was goodwill (denoted as a franchise fee in the franchise agreement).

In exchange for the franchise fee (business goodwill), the franchisee has the right to trade using the franchisor's intellectual property and system for the duration of the franchise term. This money is a sunk cost that is paid before the franchisee starts trading and is recouped over time as the franchisee derives value from the franchisor's brand. Two franchisees in the sample paid $10,000 or less in fees, and two paid more than $40,000, with the rest in between.

Liquidators are frustrated when franchisors quickly disburse money out of the franchisor entity to franchisor related companies. These funds may be paid to the franchisor's leasing company for leasing services, to the supplier company for negotiating supply contracts, and so on. This makes it difficult for the liquidators to access the money to satisfy a franchisor's creditors. The net effect of this practice is that even if the franchisor becomes insolvent soon after the franchisee has joined the system, there may not be much of the franchise fee in the franchisor's control after the franchisee has started trading. The potential for rapid dispersal of funds out of the franchisor entity should be taken into account in any solution for franchisees.

Most franchise systems offer a five-year initial term with the option of a renewal. This means that franchisees expect that the system will exist for the duration of the term and any renewal. The franchisees surveyed fitted this pattern, with more than half having an initial five-year term and most having the right to renew their franchise. They were embarking on a long-term relationship with their franchisor and made commitments on that basis.

In theory, in this relational contract the parties have considered all likely eventualities or, as a default position, they put mechanisms in place to deal with unexpected occurrences when they were negotiating the contracts.

How the purchase of the franchise is funded will depend on the amount of money needed, the amount of equity available and the available security. The survey respondents mainly purchased low entry cost franchises. Thus their borrowings were low and the risk of losing personal assets (other than savings) was correspondingly low. Only three had a total investment of more than $50,000.

Ten of the former franchisees surveyed did not borrow to buy the franchise. Three borrowed 80 to 100 per cent of the purchase costs. If the franchisor's failure meant they were no longer able to conduct the business, then they would have difficulty in servicing the debt.

Given the cost of entry into some systems, it is important that financiers be aware of the additional liabilities a franchisee will be exposed to if the franchisor fails. The viability of the franchisee's business following the franchisor's failure depends on factors such as the number of employees, the ability of the franchisee to re-brand or trade independently of the franchisee and the right of the franchisee to stay in or divest itself of premises. The surveyed franchisees did not obtain any concessions from their financier due to the franchisor's insolvency.

Once a liquidator is appointed, franchisee agreements can be regarded as an asset which the liquidator may sell. Agreements with underperforming franchisees or where the franchisor is primarily liable for cost of leasing the premises are a liability which the liquidator may choose to disclaim. The franchisee is dependent on the franchisor for support, as well as for the ongoing maintenance of the intellectual property (the brand). Franchisees have no legal right to participate in the sale of themselves as an asset, (a situation analogous to employees in the sale of a business) and insolvency is not necessarily a sufficient reason for the franchisee to terminate the agreement.

Almost without exception, franchisees lose money when their franchisor fails. Of the franchisees surveyed, eight lost between $30,000 and more than $75,000.

Causes of financial loss included legal fees, lost investment, liabilities to employees and written off fees.

The insolvency did not mean that the franchisee was unable pay business related debts. Their ability to pay these debts depended on what options were available to them to trade while the franchisor's insolvency was administered and the nature of their business.

Although almost half of the franchisees could pay some of their business related liabilities, eight could not continue trading once the franchisor became insolvent. A more detailed study would reveal where the effect of franchisor failure was felt the most keenly. It is likely that franchisees hardest hit would be those that:

- were new to the system;
- did not have specific qualifications but were attracted to the franchise, believing that they would learn from the franchisor;
- had high sunk costs (debt-servicing needs) from paying a high franchisee fee and had paid for an expensive fit-out in a major shopping centre;
- had many employees;
- did not have the lease in their own name and lost the right to the site when the franchisor's failure constituted a breach of lease;
- did have the lease in their own name and were not able to trade profitably once the franchisor failed.

In many cases, the franchisor's failure meant that the franchisee had no equity left to start a new business.

(ix) Premises

In Australia, 69 per cent of franchise systems offer franchise businesses that operate from specific commercial sites (eg, outlets in retail shopping centres, restaurants, petrol stations, hotesl, vehicle rentals); 25 per cent of franchises have mobile operations available (eg,dog washes, home services, courier services) and in 24 per cent the franchisee has the option of being home-based (eg, dog minding, book-keeping services) (Frazer and Weaven; Question D13). The right to occupy premises generally stems from one of the following sets of arrangements:

- premises owed by franchisor, leased to franchisee;.
- premises owned by franchisee, used for business. For example, home-based operations, or where the franchisee already owns a suitable retail or industrial site. Some franchise agreements specifically forbid a franchisee from owning the site;
- premises leased by the franchisee direct from the landlord. This often occurs where the business does not depend on a particular site. The franchisee has primary responsibility for the costs of the premises and the failure of the franchisor will not directly affect this relationship;
- premises leased to the franchisor by the landlord, then sub-leased or licensed by the franchisor to the franchisee. This arrangement is common when a particular type of site is desirable for the business. The franchisor aims to ensure that even if the franchisee sells or fails, the site remains within the system. In some situations (for example, Neldue Pty Ltd v Moran & Ors [2004] WASC 100; Loyal No 46 v Miller [2001] FMCA 30), the franchisee guarantees the performance of the franchisor under the head lease. This may cause problems for the franchisee if the franchisor fails. As guarantor, the franchisee may be liable for moneys owed to the landlord, but the franchisee is not guaranteed the right to lease the site if the head lease is disclaimed.

The franchisees surveyed reported a variety of relationships with landlords, with four in major shopping centres and four in stand-alone premises. Others did not rent property. Of these, only one had the lease in the franchisor's name, three held the head lease themselves and the other three had other arrangements.

The six franchisees who reported that they incurred no real estate related costs up until the time of trading were likely to have worked from home or from premises that they already had the use of, or from a vehicle.

Ongoing commitments in relation to premises are as great a concern as having the premises lease disclaimed. If the franchisee has the ongoing responsibility for the lease, but no longer has the support of the franchisor, it can be very expensive for him. However, the continuation of the lease is not normally contingent on the ongoing solvency of the franchisor. In some situations it is desirable to have the lease and the franchise agreement linked. In others it is not desirable for either franchisor or franchisee.

The leasing scenario in the franchise system conducted by Brian's Systems Australia Pty Limited (Administrator Appointed), the franchisor of Charlie's Coffee & Donuts, typifies the franchisee's predicament. There, the franchisor seems to have become insolvent because it was simply not able to deliver on promises made in the disclosure document. The administrator was appointed in February 1995. The franchisor's failure …

> '… first impacted on the lease of the (franchisee's) premises at Bankstown Square which was in the name of that company. Eventually the lease was terminated and the applicants (franchisee) accepted an offer of a monthly tenancy over the kiosk in August 1995. …'. (Smith & Ors v DCM Coffee & Donuts Limited, Charles Lee, Wayne Douglas Plant, Brian's Systems Australia Pty Limited (Administrator Appointed) Industrial Relations Commission of New South Wales 5 November 1997, Marks J, p13).

The survey revealed that one franchisee had one year remaining on the lease, four had two to three years and one had four to five years..

Where a lease has four to five years remaining it has probably only been operating for one or two years and the franchisee would be very vulnerable. In a shopping centre, a franchisee may have invested in the shop fit-out but would not have traded long enough to recoup the cost before the franchisor became insolvent. The franchisee's right to re-brand and remain in the rental premises could be at the discretion of the shopping centre manager.

(x) Stock and Plant – vehicles

Forcar rental franchises, when cars are leased to the franchisee, the franchisee has the right to use the franchisor's brand and to be a part of its network, but the leasing costs are simply a cost of doing business. Car rental franchisees usually lease vehicles from companies that are not related to the franchisor. The problems that may arise for these franchisees if the franchisor fails are similar to the problems that arise where the franchisee has the right to the lease of the premises but no right to the brand: the franchisee is left with a fixed-term lease but has no obvious way of making the vehicles pay for themselves.

Vehicles from which the franchisee runs the business are an asset of the franchisee. In these cases, the vehicle is an asset that is owned or leased by the franchisee. As long as the vehicle has not been modified to look like a lawn mower or a hamburger to comply with the franchisor's brand requirements, its value need not be altered by the franchisor's insolvency. At worst, the franchisee can remove the signage and continue to use the vehicle.

Nine franchisees obtained less than 25 per cent of products from the franchisor, three obtained between 25 and 50 per cent and one obtained most of its products from the franchisor.

Interestingly, the Traveland franchisees typically had their own suppliers of travel products, independent of Ansett or the franchisor which may explain why most of them survived the franchisor's insolvency. The response pattern to this question emphasises that there is no single solution to the franchisor insolvency issue.

(xi) Employees

In 2004, franchisees employed 18,777 full-time permanent employees and provided 13,038 permanent part-time jobs and 10,684 casual jobs. There has been a trend towards a higher number of permanent jobs in the franchising sector (Frazer and Weaven, Question D17). Survey participants were asked how many employees they had. Nine had one to five employees, four had six to ten and one had eleven to fifteen.

Employees are a business asset until there is no income to pay them, then they become a liability. While employees have rights to notice and payments when they are laid off, the franchisee has no corresponding rights to pass on the cost of the retrenchment to the franchisor.

Employees in a travel agency business will often be qualified travel agents. A franchisee will be reluctant to lay them off as the agency will lose the expertise and the goodwill they have built up with the agency's clients. The Traveland survey showed that some franchisees had to lay off staff when the administrator was appointed to the franchisor's parent company. It should be noted that 2001 was a challenging time to be selling airline travel. As well as the 9/11 attacks, other factors such as the increasing popularity of internet ticket purchasing were challenging the profitability of travel agents at this time. The uncertainty that followed the Ansett and Traveland failure would have unsettled some franchisees. Those who responded 'not applicable' may not have had any staff; or, they may have waited out the administration to see whether a suitable buyer would be found before they took staffing decisions.

The franchisees of other franchises who responded to the survey did not sell products that required specialist industry training, such as travel agents require.

Shareholders of franchisees

Shareholders of franchisee entities are also affected by franchisor insolvency as they often guarantee the franchisee's debts. Single person companies are permitted in Australia so the third of the sample reporting one shareholder may have used a corporate entity to limit personal liability. Eight of the franchisee companies had two shareholders. These were most likely to be family members.

Franchisees' status as creditors or debtors

In 1995, 'the effect of the Cut Price Deli collapse was that its unsecured creditors would become entitled only to a small distribution in respect of their outstanding debts. That category included those franchisees who had obtained prior judgements against the franchisor while those with proceedings still outstanding received nothing' (Giugni and Terry). Franchisees that had no concluded litigation with Cut Price Deli were not eligible to participate in the franchisor's liquidation.

For a franchisee to be a creditor, the franchisor must owe it money. It is unusual for a franchisor to routinely pay franchisees unless the franchise is structured under the terms of a commission agency agreement. In this case, the franchisor would collect payment for goods or services from a customer and pay the 'commission' for the sales, to the franchisee. It is more common for funds to be owed by the franchisor to the franchisee on an ad hoc basis. It is feasible for a franchisee to require the franchisor's directors to provide the franchisee with personal guarantees that commissions will be paid. If the franchisee is in a weak bargaining position, the franchisor may not agree to this. Outcomes for individual franchisees will depend on their negotiating skill.

Franchisees were asked about the payments the franchisor made to them. Half the franchisees did not receive recurring payments from their franchisors and are therefore unlikely to be classified as a creditor of the franchisor.

There was one unexpected response to the question, 'What rights did you have in the franchisor's liquidation?' because one franchisee was a secured creditor. The remaining franchisees were unsecured creditors or had no status at all in the insolvency. The unsecured creditor comes after the franchisor's employees and other creditors in terms of priority.

Recurring payments that a franchisee owes its franchisor may make it a debtor to the insolvent franchisor. Franchisees reported some form of ongoing payment to their franchisor in most cases.

If the franchisees are creditors, they are entitled to attend the franchisor's creditors' meetings. This allows them to see the magnitude of the problem and to be in direct communication with the liquidator. Liquidators say that they do include franchisees in early creditors' meetings. Therefore, it was interesting to note that only one of the responding franchisees was invited to a creditors' meeting even though it was not a creditor.

The anecdotal report of the Danoz Direct franchisor insolvency shows an effect of the franchisees being involved in the negotiations to wind up a company.

> Angry creditors of failed TV shopping network TVSN believe they have the numbers to scuttle a vote tomorrow on an agreement that would return them no more than 6.5c in the dollar.
>
> Franchisees of TVSN subsidiary Danoz Direct, who are owed more than $5 million, believe they have the numbers to vote down the deed of company arrangement (DOCA) proposed by the group's directors and administrators.
>
> Under the rules of the pooled DOCA, the agreement must be approved by a majority of each group of creditors.
>
> Sydney accountant Michael Morris, who went guarantor for his franchisee son and daughter-in-law, said the DOCA was a disgrace and a 'slap in the face' to the unsecured creditors. He said they would vote against the DOCA and take their chances in the courts, unless the administrators came up with a better offer. "'They would prefer to lose their measly maximum 6.5c in the dollar and sue the directors for their role in the failure of the business,' Mr Morris said" (*Sydney Morning Herald*, July 2005).

Liquidators' rights

Liquidators have the statutory right to disclaim any onerous contracts to which the failed franchisor is a party. These could include franchise agreements and leases of premises from which the franchisee operates. This right enables a liquidator to disclaim unsuccessful franchisees, leases for sites a purchaser did not want, or onerous leases, while retaining contractual relationships with others. The law does not require a liquidator to treat all franchisees equally.

An example of the liquidator disclaiming onerous contracts is the Kernels Extraordinary Popcorn leases (owned by Jatora Pty Ltd (Administrators appointed) ACN 075 509 590. Although the Kernel's website stated there were 25 stores (and still stated that in July 2005, four months after the liquidator disclaimed all the leases), in fact the administrator reported there were 24 Kernels stores (20 franchised, two operating with management agreements and two franchisor owned). These stores were located in shopping centres in NSW, Queensland and Victoria. The head leases were in the franchisor's name. Plant and stock in the stores belonged to individual franchisees. The administrator, in his report, says (in the Report to Creditors):

> 'I was without funds to allow the continued trading for the four corporate stores, and it was necessary for me to disclaim all of the company's leases on 24 March 2005.'

The implications for the franchisees are that if they decide to continue operating their stores they will each have to negotiate with their landlord for a new lease. Unless the franchisees band together they will each be negotiating as an independent retailer, without the expertise and group negotiating power for which they had paid the franchisor. Their weak negotiating position is exacerbated by the fact that they have already fitted out one shop and they will be aware of the cost of replacement premises if they are not able to re-secure their existing lease. Further, they had lost the $45,000 that they initially paid to the franchisor as their franchise fee.

(xii) Options for franchisees

Neither statute law or the FCC provides guidance to franchisees of a failed franchisor. It appears that a franchisee whose franchisor becomes insolvent in Australia has no right to influence the outcome of the liquidation unless it is a creditor.

Only one franchisee surveyed was buffered to some degree because of a clause inserted into the franchise agreement to protect its business in the event that the franchisor went into receivership. In this case the franchisor's insolvency gave the franchisee the right to walk away from the franchise agreement.

If the franchise system no longer exists, the franchisee usually has no specific rights in the franchisor's insolvency, and possibly no right to use the franchisor's brand, assuming it still has value. The franchisee is still contractually bound to the franchisor or whoever purchases the franchise from the liquidator.

The franchisee has to meet other contractual obligations entered into as a consequence of becoming a franchisee, such as those to landlords, financiers, suppliers and employees. None of these will be contingent on the solvency of the franchisor. One Canadian liquidator suggests that 'renegotiating the franchise agreements in order to support the franchise and preserve goodwill may be a possibility. Financing the franchisor could be considered if the franchisor's primary lenders were willing to engage in reorganisations outside formal proceedings' (Coltraine).

There are two contract claims that a franchisee of an insolvent franchisor may be able to bring: either a claim against the liquidator for unjust enrichment or a claim of fundamental breach of the franchise agreement. Both actions may have the best chance of success where the franchise term has only just begun. This would mean the franchisee has paid all up-front costs but has derived minimal benefit from the investment. It would severely tax an individual franchisee's resources to mount this action alone. Therefore, it would be best undertaken with all the other disenfranchised franchisees.

Frustration or fundamental breach of the franchise agreement

'Events may occur after a contract has been made which makes its performance pointless, more difficult or more costly, or even impossible. Such events may result in the termination of the contract by operation of law, on the basis that it has been frustrated' (Seddon and Ellinghaus p 881). The common law action for frustration or fundamental breach is basically the same in Australia as in Canada. In Canada, in Magnetic Marketing Ltd v Print Three Franchising Corp. et al (1991), 38 CPR (3d) 540, the plaintiff franchisee sought rescission of its franchise agreement based upon fundamental breach. It also sought the return of the franchise fee, royalty fees and advertising fees paid to the franchisor. In considering the issue of fundamental breach and the numerous alleged breaches of the franchise agreement by the franchisor, the court found that the franchisee had obtained substantially what it had bargained for under the franchise agreement, and accordingly it found that there was no fundamental breach of the agreement' (Goldman, 11).

Goldman explains this particular decision stating: 'Whether a fundamental breach argument has any chance of success is fact dependent. The greater the benefit that the franchisee has already received from being part of the franchised system, the less likely that the franchisor's bankruptcy will be found to have fundamentally breached the franchise agreement' (Goldman, 12).

Unjust enrichment

Also available to franchisees in Australia, though not tested in Australian courts, is the right to embark on litigation against the liquidator (because it is not possible to commence litigation against the insolvent franchisor without the court's consent), or against the directors of the failed franchisor. This action could take the form of an equitable action claiming unjust enrichment. To succeed in an unjust enrichment plea 'a restitutionary claim based on unjust enrichment depends upon the plaintiff establishing the following elements:

1) the defendant has been enriched by the receipt of a benefit. In the case of the franchisor, an up-front fee may have been charged for the right to conduct a franchise for, say, five years, but the franchisor became insolvent after two years. Therefore, three-fifths of the initial franchise fee could be the starting point;
2) the enrichment was at the plaintiff's expense;
3) it would be unjust to allow the defendant to retain the benefit; and
4) there are no bars to the restitutionary claim (no other consideration barring the claim, such as a subsisting valid and enforceable contract between the parties).

To succeed in a restitutionary claim all these elements must be satisfied. In the first instance, the plaintiff must prove elements 1-3 on the balance of probabilities. In many cases this would be sufficient. Generally speaking it is up to the defendant (liquidator) to raise the issue of a bar to restitution. Then the plaintiff must prove element 4. "If, on the balance of probabilities, the court is not satisfied that there is no bar to a restitutionary claim, then the plaintiff fails" (Davenport and Harris).

The use of an unjust enrichment action could be considered by franchisees that recently paid a franchise fee but derived very little benefit prior to the franchisor's failure. The pool of money available to the liquidator to pay creditors is artificially expanded by the franchise fee; thus the liquidator is 'unjustly enriched'. This was pleaded by a group of franchisees in Ontario, Canada in one of the Country Style Food Services cases. There, the franchisees did not act quickly or cohesively enough to succeed; the comments about unjust enrichment did not form part of the decision, but the court did not rule out unjust enrichment as a possible cause of action by the court for future franchisor insolvency cases.

Franchisee self-help

In practical terms, some franchisees find a way of making the most of the opportunities that their franchisor's failure opens to them by forming a buyers' group and continuing trading. This action was taken by former Great Australian Ice Creamery franchisees and some franchisees of one of the failed juice shop franchisors. Others re-brand and continue trading under a former competitor's banner. However this may be difficult if the area is already well serviced by another franchise system. Joining another system worked for many of the former Traveland franchisees. Yet others continue trading as an independent business, unaligned to any particular group.

(xiii) Conclusions

The conclusions in this report are based on survey responses from 14 former franchisees of franchise systems where the franchisor became insolvent. Generally, when a franchisor fails, a franchisee's assets are affected significantly and the liabilities remain unchanged. The franchisor's liquidator and the franchisee have to look to contractual rights in the franchise agreements, but most franchise agreements are silent on the rights of franchisees in a franchisors' insolvency.

The available remedies currently involve litigation based on failure of contract. They have not been tested in Australia, but have been tested unsuccessfully in Ontario, Canada. The outcome of any court action will depend on the facts of the case. The lack of success in Ontario is not an indication of what the outcome would be if similar cases were tried in Australia. Lessons to be learned from those court cases, however, are that speedy and cohesive action by franchisees will have the best chance of success, and that franchisees who are new to the system or who have recently paid to renew their franchises will be better placed to conduct successful contract-based cases than those who have already derived a significant benefit from being part of the system.

The franchising and insolvency models do not fit comfortably together. Insolvency categorises franchise agreements as 'assets' or 'liabilities' that the liquidator has the right to disclaim. This does not acknowledge the distinctive structure of the franchisor-franchisee relationship. Nor does it acknowledge the complex web of entities that makes up the modern Australian franchise system.

Further, it fails to take account of the fact that 'unlike either an employment relation or an ordinary independent contractual relation, the franchise relationship is characterised by the fact that franchisees own the bulk of the capital assets of the franchise and franchisors retain the right to determine how franchisees will use those assets' (Hadfield). This makes the franchisees a little like the franchisor's secured creditors, but gives them no comparable rights.

Hypothetically, contracts can be negotiated to at least provide a mechanism for addressing franchisor failure. However, it is highly unlikely that the sector would universally embrace contractual changes. In any case, this would be an economically inefficient solution to a complex problem.

The features that make the franchise model so adaptable to a wide range of business activities are also responsible for it being unlikely that a 'one size fits all' approach is the best way to address the problems the franchisees face when their franchisor fails. The size of the investment, the prior skill that a franchisee must have before purchasing the particular franchise, the secondary commitments that a franchisee has entered into as a direct consequence of becoming a franchisee, the length of time the franchisee has been in the system, the availability of competent buyers of the franchisor's intellectual property, and a multitude of other factors mean that providing appropriate solutions for franchisor failure is a unique challenge for the legal system.

There were specific difficulties encountered with this report which made it dififcult to identify the potential subjects, that is, the former franchisees of failed franchisors.

- There is very little empirical legal research on franchising in Australia.
- The data that ASIC collects and records does not permit identification of a company as being involved in franchising.
- Franchisees often fail to register their business names in compliance with their state or territory laws.
- Franchisees seldom contemplate the possibility of the franchisor failing when they are negotiating the franchise agreement.

Relatively few of us have been saved from serious injury by our seat belt, but for those few, life would have been very different without it. For those of us who have not had to rely on a seatbelt, we have felt a lot more relaxed knowing it was there. Any solution to franchisor insolvency must recognise that the vehicle is well designed and it works well, but there may be room for a little more consumer protection to be factored into it.

(xiv) Recommendations

The recommendations relate firstly to the negotiation of the initial franchise agreement, and secondly, to what can be done if the franchisor fails.

Negotiating the franchise agreement

Because the franchisee is still outside the system when negotiating their initial purchase, they will not know what changes other franchisees have been able to negotiate as they have gone in. Most likely, each franchisee will have a different accountant and lawyer. The greater the number of individual lawyers representing individual ingoing franchisees, the less likely it is that any of them will be able to secure any contractual rights for the franchisees if the franchisor fails.

Franchisor failure poses real challenges to the law. Currently, a franchisee's best protection lies in prevention. When the franchisor and the franchisee are having their initial discussions, the franchisee should think about how the franchisor's failure would affect him and take it into account in the negotiations.

It should be remembered, however, that the franchisee is signing a fairly standard contract. Theoretically, both parties can include any terms they agree to in the contract, but in fact, the franchisor is unlikely to change it at the request of an individual franchisee.

Going into a franchised business, the franchisee must remember that one of the worst case scenarios would be if the franchisor were to fail.

The franchisee should try to include some basic clauses in its franchise agreement to mitigate its worst potential exposures, although this would still not prevent liquidators from disclaiming all contracts, including leases and franchise agreements. The effect of franchisor failure will be different for every franchisee depending on:

- the amount of money the franchisee borrowed;
- the time the franchisee has been in the business;
- the franchisee's age;
- the franchisee's prior work experience and his education;
- the commitments he will undertake on becoming a franchisee (leases, supplier contracts, etc) and the time those commitments still have to run;
- the direction in which the money flows within the system (franchisee to franchisor (usual) or franchisor to franchisee (unusual but it does happen)).

Having identified his vulnerable areas, the franchisee might wish include clauses relating to the following items in the franchise agreement.

- Contract: The franchisee would like to be able to walk away from the franchise agreement and all contractual obligations with the franchisor and its related entities if the franchisor goes into administration or becomes insolvent. Whether the franchisee would exercise this right would depend on whether a suitable buyer was found for the franchisor's business. Franchisees with these contractual rights, acting together, would be much stronger than they currently are.
- Rights in the franchisor's insolvency: The franchisee could seek the right to vote on the suitability of any proposed purchaser of the franchisor.
- Property: Some consideration should be given to whether the franchisee would need or want ongoing access to the franchisor's intellectual property. In relation to real property, a franchisee might seek an option (negotiated with the owner of the premises) to take over the lease if the franchisor breaches the head lease.
- Suppliers: The failed franchisor will provide the franchisee with their suppliers' names, contact details and price lists for major items.
- Debts: If the franchisor is going to routinely owe the franchisee money, the franchisee could ask for security or for personal guarantees given by the directors of the franchise (or the relevant franchisor related entity). Then if the franchisor defaults on any payments that have an adverse effect on the franchisee, the franchisee can call in the guarantee in a specified (short) time.
- Default rights: If events gave the franchisor the right to terminate the franchise agreement, the franchisee would like these events to give him reciprocal rights.

Negotiating with the administrator or liquidator

Contract law and business failure law (insolvency and bankruptcy) in Australia simply do not provide viable solutions for franchisees of failed franchisors. Contract law credits franchisees with more power and negotiation skill than many, if not most, actually have. The law relating to business failure does not acknowledge the franchisee as a legitimate stakeholder.

Any proposals must be flexible enough to permit the value of the brand to be retained. However, solutions should aim to allow the franchisee to continue in business with or without the brand. Franchisees should negotiate with the liquidator as a cohesive group. The administrator or liquidator will not be able to register them as priority creditors, but he or she will recognise their value. The franchisees as a group may even be able to buy the brand. In the end though, every concession secured by franchisees in relation to every contractual commitment will be as a result of their ability as negotiators.

(xv) References

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Appendix 1

TRADING NAME	ENTITY NAME	FRANCHISOR (F) OR AUSTRALIAN MASTER(AMF)	ASIC STATUS 0605	PROBLEM
A1 Mobile Radiator Repairs	A1 Mobile Radiator Repairs Pty Ltd ACN 069 828 619	F	DRGD	1999
Century 21 Pty Ltd	Century 21(South Pacific) Pty Ltd	AMF	DRGD	1998
Collins Booksellers	Collins Booksellers Pty Ltd	F	EXAD	2005
Cut Price Deli	Cut Price Deli Pty Ltd ACN 000 917 475	F	DRGD	1995
Danoz Direct	Danoze Direct Retail Pty Ltd	F	EXAD	2005
Data Vault	Data Vault Services Pty Ltd	F	EXAD	2005
Delifrance (Australian arm)	Delifrance Australia	AMF	EXAD	2003
Furniture Wizard	The Furniture Wizard Pty Ltd	F	DRGD	1999
Great Australian Ice Creamery	Icecreameries of Australia Pty Ltd	F	DRGD	1998
ie Networks	IE Networks Pty Ltd	F	EXAD	2005
Juice Station	The Juice Station Pty Ltd	F	EXAD	2005
Kernels Popcorn	Jatora Pty Ltd ACN 075 509 590	AMF	EXAD	2005
King of Croissant	King of Croissant Pty Ltd	F	EXAD	2002
Lloyd Scott Enterprises	Lloyd Scott Enterprises Pty Ltd ACN002739773	F	EXAD	2001
Mini Tankers International	Mini-Tankers International Pty Ltd	F	EXAD	2003
Mobile Computer Cleaning	Mobile Computer Cleaning Pty Ltd	F	EXAD	2003
Modern Garages	Arbin (no 1) Pty Limited (formerly Abrogram Pty Limited,Modern Garages Pty Limited)		DRGD	1999
Mystic Crystals	Mystic Crystals Franchises (Australia) Pty Ltd	F	EXAD	1999
NoRegrets	NoRegretsAustralia	F	EXAD	2002
Nrgize	Nrgize Australia Pty Ltd	F	EXAD	2005
Office Support Services	Office Support Services International Pty Ltd	F	SOFF	2004
Old Papa’s Café	Old Papa’s Franchise Systems Pty Ltd	F	EXAD	2002
On Time Copy Centre	On Time Business Solutions	F	EXAD	2000
Only $2	Only $2 P/L 47 088 133 279	F	EXAD	2005
Party Land	Partyland Australia P/L	F	EXAD	2005
Personal Actions	Personal Action Pty Limited	F	DRGD	2003
Photo Safe	Photo Safe Australia Pty Ltd	F	EXAD	2004
Rugs Galore	Rugs Galore P/L 12 007 343 204	F	EXAD	2002?
Sam’s Seafood	Sam’s Seafood Holdings	F	EXAD	2005
Simply No-Knead	Simply No Knead Franchising Pty Ltd	F	DRGD	2000
Snow Deli	Snowdeli Pty Limited	F	DRGD	1990
Soils Ain’t Soils	Soils Ain’t Soils Pty Ltd	F	EXAD	2003
Speeds Shoes	Speeds Shoes Pty Ltd/ 326SSP Ltd; Speeds Shoes Group Pty Ltd	F	EXAD	2004
Synergy in Business	Synergey In Business Pty Ltd	F	DRGD	2002
Tokyo Joe’s	The Australian Sushi Company Pty Ltd	F	DRGD	2003/4
Top Snack Foods	Top Snack Foods Pty Ltd ACN 064 180 801; Nick Kritharas Holdings Pty Ltd (ACN 054 663 464); Adway Holdings Pty Ltd (ACN 054 201 857)	F	DRGD	2000
Traveland	Traveland Pty Ltd	F	EXAD	2001
TRIMit	Chaste Corporation Pty Ltd	F	EXAD	2001
Wonderland of Pets	Wonderland of Pets P/L and Kiltaro P/L	F	DRGD	1996

Appendix 2

CATEGORY OF FRANCHISE ACTIVITY*	TRADING NAME	STARTED	STARTED FRANCHISING	PROBLEM	KNOWN MINIMUM NUMBER OF FRANCHISEES	YEARS IN BUSINESS
12	A1 Mobile Radiator Repairs	?	1997	1999	4	?
12	Century 21 Pty Ltd	?	?	1998	?	?
12	Collins Booksellers	1929	?	2005	20	76
11	Cut Price Deli	1974	1984	1995	150	21
10	Danoz Direct	1998	?	2005	?	?
10	Data Vault		?	2005	?	?
11	Delifrance (Australian arm)	1995	?	2003	19	8
15	Furniture Wizard	1996	maybe 1998	1999	35	3
11	Great Australian Ice Creamery	1977	1982	1998	62	21
10	ie Networks	2004	?	2005	?	1
11	Juice Station	1996	?	2005	17	9
11	Kernels Popcorn	1996	2002?	2005	25	6
11	King of Croissant	1997	?	2002	1	?
10	Lloyd Scott Enterprises	1984	?	2001	?	17
10	Mini Tankers International	1991	?	2003	200	12
10	Mobile Computer Cleaning	1997	?	2003	56	?
12	Modern Garages	1988	1994	1999	?	11
12	Mystic Crystals	1993	?	1999	2	6
12	NoRegrets	1998	?	2002	600	4
15	Nrgize	2004	?	2005	8	?
10	Office Support Services	2001	?	2004	?	3
11	Old Papa's Café	2000	?	2002	3	2
10	On Time Copy Centre	1997	1998	2000	17	3
12	Only $2	1999	?	2005	25	6
12	Party Land	2000	?	2005	3	5
9	Personal Actions	1992	?	2003	?	?
10	Photo Safe	2002		2004	?	?
12	Rugs Galore	1991	?	2002?	4	11
14	Sam's Seafood	?	2004	2005	16	?
11	Simply No-Knead	1985	1989	2000	5	15
11	Snow Deli	1987	?	1990	10	3
15	Soils Ain't Soils	1980	?	2003	4	23
12	Speeds Shoes	1910	1989	2004	75	94
10	Synergy in Business	?	1999	2002	31	?
14	Tokyo Joe's	?	?	2003/4	6	?
11	Top Snack Foods	1994	?	2000	5	6
13	Traveland	1958	1990?	2001	270	43
9	TRIMit	1999	?	2001	70	2
12	Wonderland of Pets	1994	?	1996	3	2

NOTES to Appendix 2

* see next page for industry classifications
"?" in Appendix 2 indicates information could not be discovered from public recordsKey to column 1 of Appendix 2

INDUSTRY CLASSIFICATIONS IN AUSTRALIA	
Accommodation	1
Telecommunications	2
Construction	3
Recreation	4
Education	5
Finance	6
Health	7
Manufacturing	8
Personal Services	9
Business services	10
Retail food	11
Retail non-food	12
Transport	13
Wholesaling	14
Other	15

Appendix 3

	OUTCOMES FOR 14,000 EMPLOYEES OF ANSETT	OUTCOMES FOR FRANCHISEES OF TRAVELAND
Australian Federal Government's response	Air Passenger Ticket Collection Levy Act 2001 (Cth) (that established Special Employee Entitlement Scheme for Ansett Group employees) Appropriation (Budget Variations) Act 2003	Fluctuation in income triggered Australian Taxation Office tax audit following year. Those still in travel businesses acted as collection agents for Air passenger Ticket Collection levy. (this 'rubbed salt into the wound' for franchisees)
Union's response	Set up designated website, posted news about progress of insolvency; kept pressure on government not to let the employees be forgotten.	Franchisees not eligible to be in the union, not employees; and not represented as a group of claimants.
Financier's response	Funds set up by banks to help their customers who were Ansett employees	Business as usual, no recognition of problems consequent on failure of franchisor. Troubled franchisees did not consult their banks systematically.
Recognised priority in legislation	Re: wages, superannuation, leave entitlements	On ad hoc basis as: • unsecured creditors eg ticket refund owing • Debtor – owe franchise related sums.
Lost	Job Some entitlements Some of superannuation	Business while the liquidators searched for buyers. Value of trading as Traveland Cost of rebranding Some closed and lost business.

Appendix 4

AdVERT. Location	Date Ran	Cost	Response
Daily Telegraph; Business Owner Section – NATIONAL	Tuesday, 30 November 2004	$740.00	1 insolvency practitioner
The Age; Early General News section – MELBOURNE	Wednesday, 17 November 2004	$645.15	1 franchisor (solvent)
Adelaide Advertiser; Business Owner section – ADELAIDE	Tuesday, 12 October 2004	$393.36	2 former franchisees 1 insolvency practitioner
Australian; Business section – NATIONAL	Wednesday, 8 September 2004	$561.00	Australian Taxation Office in Canberra
Courier Mail; – QUEENSLAND	Saturday, 17 July 2004	$321.20	2 non franchisees including Bailiff's Office in Brisbane
Bailiff-Sheriff's Website www.bailiff-sheriffaustralia.com.au Public Notices section	Posted 19 September 2004	No charge	None
E-Travel Blackboard website www.etravelblackboard.com	Posted 9 July 2004	$50.00	3 former Traveland franchisees
Franchise Chat website http://www.franchise-chat.com	Posted a discussion topic	No charge	None

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