

Why can't I sue the Franchisor? – Exit Strategy

There are many successful Franchise systems that operate responsibly and support their Franchisees. The Franchisors have invested in their business, staff training, research and development and look to ways to improve their system for the benefit of the brand, their consumers and their Franchisees.

However, for a variety of reasons, Franchisees may have entered into a Franchise system and become disillusioned. They may have bought the wrong Franchise or:

- ☞ been “sold” on the hype;
- ☞ not objectively assessed whether there is a financial return on their investment;
- ☞ not be prepared to be held accountable;
- ☞ not have the adequate retail, marketing or management skills.

The fundamental issues prospective Franchisees should always consider before committing are.

- ☞ If there is no financial return for your effort (i.e. you can't take out a salary) and there is no return on your investment – **walk away**.
- ☞ Once you have committed there is no “easy exit” out of the system.
- ☞ There are no guarantees of any capital gain at the end so you better be able to make a return as you go on your effort (salary) and investment (profit).
- ☞ There is NO Franchise where returns are made without effort, dedication and commitment. **If it's too good to be true – guess what? It is!**

HELP – GET ME OUT OF HERE! – EXIT OPTIONS

So what are the realistic options?

- | | |
|---------------------------------------|-----------------------------------|
| ☞ Selling the Franchise | ☞ Walkout |
| ☞ Franchisor buy back | ☞ Why can't I sue the Franchisor? |
| ☞ Dispute resolution mediation - ACCC | ☞ Talk / communicate negotiate |

1. Selling the Franchise

Selling the Franchise to a third party approved by the Franchisor for the best possible price. This generally can only occur where the business is operating profitably. It's a buyers market, no one will be generous.

No buyer will care how much it cost you to get into the business they will only offer what they consider to be the market value based on its current and recent trading history and performance.

The benefit: Franchisees will nevertheless (depending on where they are on the unhappiness cycle) sell to release themselves from ongoing costs to creditors and landlords, even if that involves “crystallising” a loss.

In some cases, this is a sensible option and one that enables the Franchisee to move on having had an experience not to be repeated.

The key here is that the Franchisee will crystallise a loss but may be left with a manageable debt to deal with.

2. **The Franchisor Buy Back – why would they?**

This is difficult as most Franchisors are not in the business of buying back their Franchises. However this can occur and we have negotiated this in a number of cases in a variety of systems. A key consideration may be that, despite the poor performance of the Franchisee, the Franchisor may consider that the Franchise site is in a strategic location. Basically they see value in maintaining the site or brand presence and be prepared to pay something for that.

A Franchisor in these circumstances will not be generous and will negotiate the least possible payment to the Franchisee. This will generally be an offer to purchase the plant and equipment at written down value plus stock with any arrears owing to the Franchisor being set off from those amounts. Anything more than that should be considered and accepted by a Franchisee if they have no other options.

The benefit: The Franchisee is released from ongoing obligations under the Lease and operating costs. The Franchisee will realise very little in removing the fit out they own as they would have to make good any damage. This can be used as leverage in some cases when dealing with the Franchisor.

3. **Dispute resolution / mediation**

A Franchisee should contact the Franchisor representatives directly, discuss the issues and attempt to find practical and compromised outcomes.

Ensure any discussions are confirmed in writing so there is a recorded history of attempts made to resolve the issue.

Franchisors representatives are well trained not to put things in writing.

If a Franchisee is unable to resolve matters from direct discussion with the Franchisors Area or State Manager, the issue should be taken to a higher level and if possible to one of the Directors of the Franchisor company.

It is often the case that once a Franchisor Director is aware of a legitimate complaint that has not been dealt with appropriately at a lower level the matter can be resolved.

In circumstances where there is a more substantive issue this may be more difficult and it may be necessary, if there is no adequate response to activate the dispute resolution provisions under the Code and seek a mediation.

The Mediation

The benefits of mediation to a Franchisee are;

- 🔗 The Franchisor is required to attend and in good faith, seek to resolve the dispute under the Code.

- ☞ An independent mediator, objective of the parties is engaged (usually an experienced Barrister) who can identify the legal issues and assist the parties to find solutions;
- ☞ The mediation process itself means that you can focus the attention of the Franchisor solely on your issues on that day.
- ☞ All matters at mediation are discussed in confidence and can not be used in later proceedings and therefore the parties can speak, openly and consider practical outcomes.
- ☞ Irrespective of a successful outcome the Franchisee will better understand the Franchisors position and hopefully vice versa.
- ☞ The resolution is in the hands of the parties, not a third party (i.e. a Judge).

Other considerations – ACCC

- ☞ Once the dispute resolution process is activated, it does not prevent a Franchisor from terminating a Franchisee however, it is arguable that a Franchisor should not terminate a Franchisee, where there is a legitimate dispute as this may be considered unconscionable conduct.
- ☞ The mediation process can simply buy the Franchisee time to think and plan.
- ☞ Consider a written complaint to the ACCC. If the issues affecting the Franchisee relate to a number of Franchisees in the system the ACCC may be interested in stopping the unlawful behaviour of the Franchisor continuing. This can also be a useful leverage option when the ACCC has, in fact, taken action against a Franchisor, where orders have been obtained against a Franchisor in the Federal Court, or undertakings have been given by the Franchisor to the ACCC or to Court.

4. The walk out

This certainly crystallises a loss, exposing a Franchisee to a claim for breach of the Franchise Agreement. The consequences are that the Franchisee may be exposed to a claim for loss and damage. The Franchisee will also be subject to a restraint of trade, and will not be able to operate a similar business in competition to the Franchise business in their site or within the period and radius of the location. This option, often the last resort should be carefully considered.

5. So why can't I sue the Franchisor – will the court law see it my way, and fairness and justice prevail? –

5.1 Clearly there are a number of considerations;

- ☞ Is it feasible to sue the Franchisor whilst a Franchisee is still in the system? Unlikely, although it may be necessary to bring injunctive action to stop a Franchisor terminating unlawfully.
- ☞ Even where a Franchisee has exited the system there are some threshold issues to consider before suing the Franchisor.

Do you have a "cause of action"?

Even if there is a:

- ☞ *Breach of the contract by the Franchisor.*

- ☞ *Breach of the Franchising Code of Conduct.*
- ☞ *Breach of the Trade Practises Act provisions, for example – Section 52 misleading and deceptive conduct, unconscionable conduct, third line forcing, resale price maintenance issues.*

Is there objectively sufficient evidence to substantiate a claim that meets the necessary legal proofs? The burden of satisfying a Court is on the party who instigates the claim!

- ☞ Even though you may have the strongest and clearest case in the world, do you have the financial means to be able to bring the proceedings. It may take many years to resolve. The Franchisor will defend the claim and will have deeper pockets. Is it worth spending \$50,000.00 to \$120,000.00 on a legal case where the return is at best, uncertain. As you would for a business investment it is necessary to conduct a costs benefit analysis factoring in a component of risk

5.2 Risks of litigation

The one certain thing about litigation is that nothing is certain!

The mediation process can usually lead to a more successful outcome because the parties themselves are in control of the outcome.

In Court, matters are generally beyond the control of the parties and even your legal team. The parties are in the hands of a Judge who may or may not see things the way you have.

Ask any lawyer and they will all tell you the experience of inexplicably losing the “best case” or winning the “worst case”. Why? Human judgment and subjective assessment A Judge may not see things the way you do. Sharp commercial conduct by a Franchisor is not necessarily unlawful.

5.3 Are legal proceedings a good investment? Absolutely not!

Consider that you have \$50,000.00 to put towards a legal action, having walked away from the Franchise carrying a debt of \$350,000.00 secured over your home.

Do you put that \$50,000.00 towards suing the Franchisor “in the hope” that you may, after a lengthy legal battle recoup some part of your \$350,000.00 in circumstances where:

- ☞ The outcome will be uncertain.
- ☞ Based on a subjective assessment of a third party.
- ☞ If you succeed, to what extent, once legal costs eat into any return as you may only recover a portion (60%) of your actual costs?
- ☞ The Franchisor may make an offer (but they may not!).
- ☞ Balance that against investing the \$50,000.00 for your future needs, or in a new business opportunity which may give a more certain outcome.

7. Better to talk - communicate – negotiate

Some of the keys to a successful negotiated outcome with Franchisors from our experience have been;

- 🌀 Open the lines of communication with the Franchisor at the right level;
- 🌀 Don't threaten the Franchisor with legal action or going to A Current Affair;
- 🌀 Arrange to meet and discuss sensible and realistic options. Don't aim unrealistically too high!;
- 🌀 Apply strategic pressure where and when required – pick when to use any leverage that you may have.
- 🌀 Avoid the “gung ho” litigation lawyer keen to commit you to a long and costly court battle.
- 🌀 **To seek objective strategic advice from an experienced Franchise lawyer who can assist you to explore the right strategy for you.**

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