

## Why can't I sue the Franchisor? – Exit Strategies

There are many successful Franchise systems that act responsibly and support their Franchisees. Franchisors have a vested interest in their business, staff training, research and development and look at 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;
- Gone into the Business and found it's not for them, they actually don't like the work and it's not what they expected;
- Failed to objectively assess whether there is a financial return on their effort and investment;
- They are not prepared to be held accountable and follow the system they bought into;
- Or their personal or financial circumstances may have changed since becoming a franchisee due to health, family or other reasons.

There are some fundamental questions a Franchisee should ask themselves, before committing to a Franchise.

- Is there a financial return on their effort? Can you take out a reasonable salary for your effort? If not – **walk away.**
- Once you understand and commit there is no “easy way” out.
- Is the business sustainable or a passing fad?
- Are you likely to have something of value to sell in the future?
- Can you see the brand and business building goodwill?

There is NO Franchise or business where returns are made without effort, dedication and commitment.

**If it is too good to be true – guess what? It is!**

### HELP – GET ME OUT OF HERE! – EXIT OPTIONS

So what are the options for a franchisee?

- Sell the Franchise
- Franchisor buy back (unlikely)
- Walk out
- Dispute resolution through mediation
- Negotiating an exit

## 1. Selling the Franchise

Selling the Franchise to a third party approved by the Franchisor for the best possible price generally can only occur where the business is operating profitably.

It's a buyer's market, no purchaser will be generous and there are hundreds on the market.

To be in the best position to sell and maximise a return ensure your financials are up to date and leases and material contracts signed and up to date.

A buyer will not care how much it cost the Franchisee to get into the business and that doesn't establish its "value". They will only offer what they consider to be the market value of the business and the assets, based on it's then current and recent trading history and performance.

**The benefit of selling:** The Franchisee will (depending on where they are on the unhappiness cycle), release themselves from ongoing operating costs and liabilities.

It may be the best option to enable the Franchisee to move on, having had an experience not to be repeated!

The Franchisee here will likely crystallise a loss but at least be left with a manageable debt to deal with.

Selling the franchise, being released from a Lease and recovering a security deposit (if any) may be a better option than holding out to recover goodwill that no one will likely pay.

The message here if a vendor be realistic. Don't over value your business if you really want to be on the market and have a reasonable chance of selling.

It is also important to ensure all your documents are in order, your lease signed, options exercised, and your financials are up to date.

## 2. The Franchisor Buy back – why would they?

This is difficult as most franchisors are not in the business of buying back their franchises. We have negotiated this in a number of cases in a variety of systems. A key consideration maybe that despite the poor performance of the franchise outlet, the Franchisor considers the franchise site to be a strategic location. Basically, they see value in maintaining the site and brand presence and they may be prepared to pay the franchisee 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 set off from those amounts. Anything more than that should seriously be considered by a Franchisee, if they have exhausted all other options.

**The benefit:** The Franchisee is released from ongoing obligations and liabilities under the Lease and franchise agreement. The Franchisee will realise very little by removing the fit out as they would have to make good any damage and the value of the fit out is minimal where after it is removed.

### 3. The walk out

This will certainly crystallise a loss and expose a Franchisee to an allegation of breach of the Franchise Agreement and a claim for loss and damage by the Franchisor. The Franchisee will also generally be subject to a restraint of trade, and not be able to operate a similar business in competition to the Franchise business.

This option is often the last resort where a Franchisee is trading insolvently and having to dig into their own funds and savings each week to pay the overheads, staff and suppliers to keep the doors open. Get legal advice before you act on walk the door to understand your risk and exposure.

**The Risk:** It exposes the Franchisee and their personal assets, landlord, a claim potentially by the suppliers and Franchisor.

So, once you walk out it's just the beginning you will not know what your eventual exposure will be for some time.

**The Benefit:** You relieve yourself from an unhappy and stressful environment and it may enable a Franchisee to take up a better income earning opportunity.

### 4. Dispute resolution / mediation

If a dispute arises the Franchisee should contact the Franchisor representative directly, and discuss the issues and attempt to find, a practical and compromised outcome.

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

The Franchisor representatives are well trained in not putting things in writing, so follow up your discussion with an email to them which can then be relied on at a later date if need be.

If a Franchisee is unable to resolve matters by direct discussion and negotiation with the Franchisor's 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 Director is aware of a legitimate complaint, that has not been dealt with appropriately at a lower level the matter may be resolved.

Where there is a substantial issue and no adequate response the Franchise Code enables either party to activate the dispute resolution provisions, under the Code and seek mediation.

#### The Mediation

The benefit of mediation to a Franchisee are;

- The Franchisor is required under the Franchise Code to attend the mediation and devote their attention to your matter.
- Each party must act in good faith to try to resolve the dispute under the Code. This obligation is now entrenched in the Code.
- An independent mediator, objective of the parties is engaged (usually an experienced Lawyer or Barrister) who can identify the legal issues and assist the parties to find commercial solutions.
- The mediation process means that the Franchisee has a chance to focus the Franchisor's attention solely on their issues on that day.
- All matters at mediation are discussed in confidence and can not be used in later proceedings. The parties can therefore speak openly and consider practical outcomes.

- Irrespective of a successful outcome at the mediation the Franchisee will better understand the Franchisor's position, and hopefully vice versa and other strategies and options can then be considered.
- The resolution is in the hands of the parties, not a third party (i.e. a Judge).
- It is far less costly than proceedings in Court.

#### Other considerations

- 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 once the dispute resolution process is activated.
- To do so may be considered unconscionable conduct by a franchisor and a breach of the obligation to act in good faith under the Code.
- The mediation process can simply buy the Franchisee time to think and plan.
- The focus at franchise Mediation tends to fall into two categories:
  - Raising operational issues, breaches or failures by one or other party of their obligations and resolving those issues so both parties can get on with Business; or
  - Focusing on an exit plan and the terms of exit, on the basis the relationship has irretrievably broken down and each party feels it best to go their separate ways,
- Franchisees may also consider a written complaint to the ACCC. If the issue affects a number of Franchisees in the system, the ACCC may be interested in investigating and stopping any breach or unlawful behavior of the Franchisor. This can be useful leverage if the ACCC has taken action, or orders have been obtained against a Franchisor in the Federal Court, or undertakings given by the Franchisor to the ACCC or to Court.
- The ACCC since 1 January 2015 now has extended powers to impose penalties and fines on noncompliant Franchisor's and therefore Franchisors need to be even more vigilant about code compliance, from 1 January 2015.

#### 5. So why can't I sue the Franchisor? Will the Court see it my way? Will fairness and justice prevail?

We have all seen "The Castle" a great Australian movie where the Solicitor stands up before the High Court and says, "*It's the Vibe your Honour*". Unfortunately, the "vibe" doesn't fly in our legal system. Evidence does - emails, letters, notes of discussions, glossy brochures promising the world, financial information and statements made of possible returns, forensic expert evidence of loss are what a court wants to see.

##### 5.1. There are a number of considerations;

- Is it feasible to sue the Franchisor whilst the Franchisee is still operating in the system? This is unlikely, although it may be necessary to bring an injunctive action to stop a Franchisor unlawfully terminating or other adverse conduct.
- Even if the Franchisee has left the system and considers taking legal action there are some threshold issues to consider before rushing off to Court.

*Does the Franchisee have a recognised legal “cause of action”?*

Is there a:

- *Breach of contract by the Franchisor; or a*
- *Breach of the Franchising Code of Conduct; or a*
- *Breach of the Australian Competition and Consumer Act 2010 (ACL), for example – misleading and deceptive conduct, unconscionable conduct, third line forcing, resale price maintenance breaches that can be relied on and pleaded.*

*It may be a combination of all those things and usually is.*

*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 on the “balance of probabilities”.*

*Issues of fairness and justice are a subjective concept and do not equate to legal principles of equity and justice.*

Often representations or promises that were relied upon by the franchisee were verbal and not in writing.

They may have been made by the Franchisor at the time in good faith and therefore found not to be misleading.

How do you prove those statements were made when they may have been some years earlier and they will no doubt be denied by the Franchisor or their representative?

These are all practical, but very real problems in substantiating a claim or cause of action in Court.

- Even if a Franchisee has strong and clear evidence, do they have the financial means to bring proceedings which may take years to resolve?
- Here are some litigation pearls of wisdom from 30 years of litigation experience.
  - The one thing certain about litigation is that nothing is certain!
  - Litigation is expensive and involves spending money to recover money? Is that wise?
  - Litigation is highly demanding financially and emotionally and carries enormous risk!
  - Don't litigate if you can't afford to go all the way and don't litigate if you can not afford to lose!
- The Franchisor will likely defend any claim and have deeper pockets. Is it worth spending \$50,000 to \$120,000 on a legal case, where the return is at best, uncertain?
- As with any business investment conduct a cost benefit analysis factoring in a component of risk and from that, make an unemotional decision with experienced legal advice. After all, it is all about money, loss and risk.
- There are cases where litigation may well be necessary and the only option and means to bring about a settlement.
- Each case has to be carefully examined based on its own facts.

## 5.2 Risks of Litigation:

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 your way.

Ask any lawyer and they will tell you the experience of inexplicably losing the “best case” or winning the “worst case”. Why? Human judgement and subjective assessment.

Sharp commercial conduct by a Franchisor is not necessarily unlawful or unconscionable conduct. Understanding the franchise relationship and the rights and obligations is crucial and having Lawyers experienced in Franchise Law will assist you to make an informed decision before you start.

There have been a number of recent cases where Franchisees have issued claims against Franchisors and lost.

The legal threshold to succeed in these cases is high and requires supporting documentary and forensic evidence from accountants and experts which can be extremely costly.

## 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 \$250,000.00, 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 \$250,000.00 in circumstances where:

- The outcome will be uncertain.
- Based on a subjective assessment of a third party (a judge).
- If you do succeed, to what extent? Once legal costs eat into any return, as you may only recover a portion (60%) of your actual legal costs.
- The Franchisor may make an offer during the proceedings (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 return.
- These are all things to consider.

## 6. The better option: Talk – Communicate – Negotiate

Some of the keys to a successful negotiated outcome with Franchisors from my 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" before giving them an opportunity to respond.
- Arrange to meet and discuss sensible and realistic options. Don't aim unrealistically too high or put forward "blue sky" offers.
- 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 - it's great for the Lawyers!
- Seek objective strategic advice from an experienced Franchise lawyer who can assist you to explore the right option and strategy for you.
- As a Lawyer with over 30 years' experience in Litigation, Business and Franchise Law I have seen it all, and that experience is what my clients look for.

### CONTACT:

**Robert Toth | [rtoth@franchisedevelopments.com.au](mailto:rtoth@franchisedevelopments.com.au)**

**Accredited Commercial Law and Franchisee Specialist | Member of the Franchising Council of Australia (FCA) | Member of the International Franchise Lawyers Associations (IFLA)**

