

# Emerging companies



FRANCHISE

## QUESTIONS OF CONTRACT

When is a licence a franchising agreement? The answer may be significant for many small businesses.

Report: Jane Lindhe

• The case of a New South Wales confectionery retailer being prosecuted by the Australian Competition and Consumer Commission for alleged Trade Practices Act breaches could have bigger implications for small businesses that operate by licensing their brands or business systems, lawyers warn.

The ACCC has issued proceedings in the Federal Court against Personalised Chocolates 4U and its sole director, Troy Patching. It alleges PC4U breached the franchise code of conduct and, subsequently, the Trade Practices Act, by making false, misleading and deceptive representations to its franchisees.

Lawyers say the case is a warning to franchisors that they must be able to prove they can deliver on promises they make to new franchisees, especially

when more people are looking to invest in franchising opportunities.

The ACCC alleges the Wyoming, New South Wales, business – which sells personalised chocolates for weddings and other events – operated a franchise business while claiming to use a licensing model. The law requires franchisors to abide by an industry code of conduct, irrespective of whether they consider themselves a franchise or not.

The ACCC says PC4U reneged on its promise to provide franchisees with software and a manual relevant to running the business. It also alleges that the company claimed it would offer refunds of franchise fees in some cases, but that the conditions in which a refund would be granted were “impossible for the franchisee to meet”.

PC4U’s website guarantees “if you don’t make 5x your investment back in two years and if you want to hand back your franchise we will cut you a cheque for double”. Among other claims, franchisees have “no ongoing royalties, no staff, needs minimal stock and no limit as to how much money you can make ... all on a ZERO risk, double your money back guaranteed basis”.

Patching says his company is currently selecting a lawyer to conduct a second independent review of its business and its contracts. He says it is still trading and its 45 licensees are still making money, but inquiries for new agreements have slowed since the ACCC announced it was pursuing the company.

“Maybe we did make a mistake in a few areas,” he says. “[Our lawyers] will oversee all of our agreements to see what they are and what they are not.”

The “zero risk” claim on PC4U’s website is likely to have concerned the ACCC, a Mills Oakley Lawyers partner, corporate advisory, Warren Scott, says. Claims that a business deal presents no risk are extremely difficult to prove, he says, and the money-back guarantee could also be problematic.

“In this case involving the money-back guarantee, section 51A of the Trade Practices Act applies – in which a reversal of the onus of proof needs to be made by the franchisor about how they can provide such a guarantee,” he says. “That is extremely difficult to prove.”

Scott says the reputation of franchising is dependent on the regulator taking action against franchisors who are not complying with the code. However, he says the broad definition of a franchise agreement contained in the franchise code of conduct means that many contracts that may be considered to be a licensing agreement are in fact franchise agreements.

“An agreement which involves the use of a brand as well as payment of money and either a system or a marketing plan is at risk of being a franchise agreement,” he says.

“To avoid a return to past poor practices from within the franchise industry, the code needs to be seen as a non-negotiable minimum business obligation for all franchisors.”

Scott says the lesson from the case should not be that licensing is no longer a viable business strategy. In some circumstances, it is appropriate for a business to operate via a licence rather than a franchise agreement, he says. But businesses seeking to grant licences should consider the breadth of the definition of a franchise agreement.

The message on PC4U’s website is confusing to potential franchisees. While its website displays the link, “start your own franchise”, another section describes the arrangement as a licensing agreement. It claims that a deluxe licence, which costs \$4997 – including a one-off payment of \$2997 and 12 monthly payments of \$197 – provides value of more than \$75,000.

“It is often important in the proof-of-concept stage that small businesses or entrepreneurs are able to license rather than franchise their business idea,” he says. “While the cost of compliance with the code is not high, it is one driver which sees some businesses seeking to operate under a different business model, at least in their early stages.”

The ACCC is seeking various orders such as declarations, injunctions, corrective notices, findings of fact and costs. It has also ordered that PC4U implement a trade-practices compliance program and that Patching attend trade practices law compliance training.

The matter is listed for a scheduling conference in Sydney on August 28. **BRW**



**The code needs to be seen as a non-negotiable minimum business obligation**

Warren Scott, Mills Oakley Lawyers



## Aussie is much more than a mortgage broker; it really is becoming an alternative to the banks across a range of retail financial services

Stephen Porges, Aussie Home Loans

"I had a stellar time in New York, but September 11 put everything in context. It was a life-altering moment for anyone who was there. In the end, we wanted our children to grow up in Australia."

Porges and his family returned to a farm near Orange, which was the family base as he worked as a company director and investor in Sydney before eventually joining Newcastle Permanent.

It was a fruitful time for Porges, who oversaw a \$330 million fund raising from United States investors, expansion of the society's branch network and two building society of the year awards.

"Aussie was not on my radar and mortgage broking was not something I'd thought about," he says. "But Aussie is much more than a mortgage broker; it really is becoming an alternative to the banks across a range of retail financial services."

Porges is chief executive at a crucial time in Aussie's transformation into a much broader, more complex financial services company. Commonwealth Bank of Australia announced its acquisition of 33 per cent of Aussie just two weeks after he had settled into his new office.

Aussie's official statement noted that Symond "will continue to be the driving force behind the group".

By December 2008, Aussie's growth strategy was off and running with the acquisition of Wizard Home Loans from GE Money, providing it with a national branch network in addition to Aussie's existing network of mobile lenders.

Aussie has a loan book valued at \$32 billion, 136 outlets – most of them converted Wizard stores – and 400 mobile lenders. In addition to home loans, the group's product range includes insurance, credit cards, car loans and personal loans.

Porges foreshadows further acquisitions and the addition of more financial products and services.

"This is a great time for us as a business," he says.

Aussie this month considered buying real estate group LJ Hooker, which its present owner, Suncorp, has on the market, but despite the attraction of LJ Hooker's national mortgage broker network, selling real estate is not on Aussie's agenda.

"We did a preliminary analysis and it looked like an interesting opportunity, but it's a slight step away from our core competence," Porges says.

The next likely extension of Aussie will be the addition of financial planning services.

"We have to be a consumer champion in a lot more areas and financial planning is the next obvious one," Porges says. "The last four months we've been doing a lot of analysis of the sector."

One thing is certain, however. When the time comes to make the announcement, it will be Symond who will be fronting the media.

While it is not unknown for the chief executive of a private company to work alongside a hands-on chairman, usually the founder of the business, sharing leadership is inherently tricky.

A senior Sydney headhunter who works in the financial services sector – who was not aware that Aussie had appointed a new chief executive and was prepared to discuss the arrangement only on condition of anonymity – says Porges has obviously gone into the role with his eyes open, "but usually in these circumstances it's more of a chief operating officer role than a CEO, someone who enjoys being a kind of back-office CEO".

The headhunter says he is aware of similar arrangements.

"It typically doesn't end well. Typically the [chief executive] decides to move on because it can be difficult for an individual who is stuck in the shadows."

Corporate affairs adviser Marjorie Johnston, who also was unaware that Porges was chief executive, questions the wisdom of giving the chief executive such a low profile.

"It troubles me that a company would say, 'We don't care that the CEO is not well known because we want to promote the chairman'.

"Even if that's alright now, what about in five years' time when the company will be a different animal, when John Symond finally does retire?

"How will the board feel then that it didn't do even the most basic work to position the CEO or the role of CEO?" BRW