

The 7-Eleven (and more) saga and why new laws to protect franchisee workers should be passed by Federal Parliament

A briefing paper. March 2017

1. Summary

The Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 is a needed step that is necessary to protect workers from exploitation under some franchising business models that arguably encourage, and even require, exploitation of workers in order for franchisees to survive.

2. Background

In August 2015 a story broke in *The Age* and *Sydney Morning Herald*, '[7-Eleven: A sweatshop on every corner](#)'. The exposé detailed how employees of 7-Eleven franchisees were underpaid and exploited through work visa scams and others.

The billionaire owner of the 7-Eleven franchisor, Russell Withers was, at the time, chair of the Franchise Council of Australia (FCA). In September 2015 [he resigned as chair](#).

In its attempt to manage the crisis, 7-Eleven appointed an independent investigative panel headed by ex-ACCC boss Alan Fels, but in May 2016 '[sacked](#)' the panel. Fels asserted that 7-Eleven were wanting to 'discredit the panel' to 'give themselves an excuse for managing the process...'

The allegations and findings of underpayment and exploitation have not been restricted to 7-Eleven. For example, just this month, Dominos pizza chain has been [subjected to similar allegations](#), including parliamentary investigation.

The revelations have expanded so that the very authenticity, and legal and ethical basis of franchising in Australia are now under question. The Franchise Council of Australia (with its Executive Chair, former Abbott government Small Business Minister Bruce Billson as an active player) is seeking to defend franchising and stop the new laws.

3. The 'Protecting Vulnerable Workers' Bill: For-and-Against

In response to the underpayment and exploitation findings, the Federal Government is introducing new legislation so that franchisors are included in the worker payment responsibility chain.

At the core of the [Fair Work Amendment \(Protecting Vulnerable Workers\) Bill 2017](#) is the following clause that extends liability to franchisors where franchisees have underpaid workers.

Part 2- Liability of responsible franchisor entities and holding companies

558B (ii) (if) at the time of the contravention by the franchisee entity, the responsible franchisor entity ... knew or could reasonably be expected to have known that a contravention by the franchisee entity ...was likely to occur...etc

This clause would effectively impose obligations on franchisors to pay workers correctly.

The Franchise Council of Australia is opposing the law, with FCA Chair Bruce Billson acting as the public face of its campaign. In a [recent article](#) in *The Australian*, Mr Billson called the laws "...a media-inspired regulatory misadventure..." that "...represents an existential threat to the successful franchise model of enterprise."

We disagree. The laws are a much-needed step necessary to protect workers from exploitation under some franchising business models that arguably encourage, and even require, exploitation for franchisees to survive.

In opposing the new laws, the FCA arguably protects those franchising business models that lend themselves to exploitation. In doing so the FCA puts at risk the more ethical franchising models. To understand this, it's helpful to understand the FCA, its history and the two broad models of franchising.

4. Franchise Council of Australia. [<https://www.franchise.org.au>]

The FCA presents itself as the peak industry body representing franchisors and franchisees. It conducts extensive marketing activities promoting franchising as well as expending considerable resources on advocacy and lobbying on franchising issues. [Here is a list](#) of the names and profiles of the current FCA board members. Since the 7-Eleven scandal broke, the FCA has had several chairs. One of the more interesting people on the board is Stephen Giles.

According to the FCA, Stephen Giles has been "...a member of the Franchise Council of Australia almost since its inception ...and has been a national director of the FCA since 1997, handling the portfolio of Industry Regulation and Government Relations." Mr Giles is also a partner with Norton Rose Fulbright (lawyers) leading the firm's legal practice representing a significant number of Australia's largest franchisors.

Independent Contractors Australia has had a considerable number of dealings with the FCA and Mr Giles over many years. ICA has found itself persistently advocating for small business reforms opposed by the FCA.

When the current FCA chair Bruce Billson was Shadow Small Business Minister, [he said of the franchisors body](#): "The FCA's advice ... is quite unconscionable in its intentional omissions and misrepresentations."

Those sentiments reflect ICA's experiences with the FCA.

In ICA's experience, the FCA:

- Opposed the introduction of Small Business Commissioners in several of the states.
- Opposed the introduction of new franchising laws in Western Australia.
- Opposed improvements to the federal franchising code of conduct.
- Opposed the introduction of the unfair contract laws.

Each of these laws involved rebalancing the power imbalance frequently evident between large and small businesses, including between franchisors and franchisees. Each of these laws, in one form or another, reduced the capacity of franchisors to unilaterally dictate to franchisees.

Once more, we at ICA find ourselves advocating for a new law that the FCA opposes. This new law, the *Protecting Vulnerable Workers Bill*, will impose obligations on franchisors to ensure correct and legal payment to employees of their franchisees.

5. Franchise Business Models. The good. The dubious.

5.a The general picture

The modern form of franchising was 'invented' and developed by the business mastermind behind McDonalds, Ray Kroc, in the 1950s. As detailed in the McDonalds' story '*Behind the Arches*', the franchising model has several key features:

- The franchisor develops a system of product creation, supply chain management, marketing, shop/premises design and so on, and through contractual arrangements applies discipline to ensuring consistency and quality on all these matters.
- The franchisee 'buys into the system' agreeing to comply with the disciplines of the system.

Franchising is successful because it combines the advantages of small business with the benefits of big business.

- The small business franchisee is close to customers (the market) and has a personal financial stake in making sure each customer is happy. This is the key to the small business culture.
- The big business franchisor brings the advantages of disciplined systems, bulk purchasing, supply chain management and so on.

But for franchising to succeed, the relationship between the franchisor and the franchisee is central. It's here that two divergent models exist.

5.b The good model

The 'good' franchising model is probably typified by McDonalds. In the McDonalds' system, great emphasis is placed on the franchisee being successful and making money at each retail outlet.

The franchisee:

- Pays a lot to acquire a McDonalds franchise
- Will go through several years of training by McDonalds including training at 'McDonalds University' before being granted a franchise.
- Must have considerable experience working at McDonalds outlets before being granted a franchise.

McDonalds as a corporation makes money from the business operation of a franchisee through profit-sharing, but also makes money from leasing equipment to the franchisee and so on. However, McDonalds real financial strength is in its property holdings where it owns the McDonalds store properties. McDonalds is one of the largest property owners in the USA.

The key to this 'good' franchising model is that both the franchisor and franchisee make money. Under the 'good' model, franchisee turnover is low.

5.c The dubious model

The 'dubious' model appears on the surface to be the same as the 'good' model but there is a huge difference. Under the dubious model, the franchisor makes money from selling franchises and from franchisee turnover.

- If an existing franchisee goes broke and a new franchisee takes over, the franchisor makes money by charging the new franchisee a fee. High franchisee turnover means more revenue for the franchisor.

- Under this model a franchisor will start up an additional franchise store near a successful franchisee reducing the successful franchisee's profit, even threatening their profitability.
- The franchisor will increase charge rates for supplies, marketing and so on, gouging profit from successful or even marginal franchisees.

That is, under this dubious model, the franchisor's interest is only the profit of the franchisor with little or no interest in the franchisee's success or profit. This dubious model relies on:

- powerful marketing to constantly induce new entrants into franchising, selling 'hopes' and 'dreams' of financial success.
- the capacity to impose and enforce contractual arrangements where the franchisor has (essentially) dictatorial power over franchisees. Government regulation, such as mandatory codes of conduct, unfair contract laws, enforceable, cheap, dispute-resolution processes and so on reduces the franchisor's dictatorial powers, thereby threatening the 'dubious' franchising model.

And further

- if franchisees break the law, franchisors are able to claim immunity and non-responsibility because the franchisor is at contractual arms' length from the franchisees' law-breaking. This can be a legitimate arrangement, but is also the situation related to the underpayment and exploitation of workers in some instances.

This dubious model creates a business environment for franchisees where they are under enormous pressure to reduce costs because their business is marginal or not viable. In such circumstances, cost-cutting by underpaying workers is an obvious path that many would take. In fact this franchise model almost induces and demands underpayment.

6. Worker exploitation under franchising

As discussed above, the *Protecting Vulnerable Workers* Bill will make franchisors responsible for underpayment of workers where the franchisor knew or should have known of the underpayment. The FCA argues against this. However, ICA argues that franchisors ensuring that franchisee workers are paid correctly should be a normal part of the contractual franchise arrangements required of franchisees by franchisors. Take McDonalds, for example.

McDonalds Corporation in Australia [has an enterprise agreement](#) stipulating the pay rates to be paid to workers at McDonalds. The agreement clearly includes obligations on franchisees to comply with the pay rates. (See page 2 of the agreement 'definitions' 'employer'.) On a reasonable reading of this agreement, it is arguable that if a McDonalds' franchisee worker were underpaid, that McDonalds Corporation would be obligated to compensate for the underpayment should the franchisee fail to make the payment.

Further, franchisors impose wide-ranging and onerous obligations on franchisees not only to ensure compliance with business operational issues but also because of mutual obligation requirements.

If, for example, a consumer suffered food poisoning from eating a pie from a 7-Eleven store, the responsibility and liability obligations are imposed under food safety laws through the entire supply chain. This would include in this example, the franchisee, 7-Eleven as the franchisor, the delivery-company, warehouse, pie manufacturer and so on. Everyone is

responsible for matters they control. The same applies under work safety laws, defective products under the Australian Consumer Law and so on.

The *Protecting Vulnerable Workers* Bill will create a legal circumstance where dubious franchisors could not afford to ignore underpayment and exploitation of workers by franchisees. Franchisors will need to:

- Include in their franchise contractual arrangements instructions and obligations on franchisees to pay according to legal requirements under awards at least.
- Audit and monitor franchisees to ensure worker payments are legal.
- Establish independent worker complaint mechanism to ensure that where underpayment occurs that this is discovered and rectified quickly.

For many franchise operators such as McDonalds this will not concern them because this is what they would already be doing. However the *Protecting Vulnerable Workers* Bill will have an impact on dubious franchisor operators because it presents a threat to their very business model.

7. Conclusion

In the opinion of ICA, the Franchise Council of Australia should consider its position carefully. If the FCA continues to oppose the *Protecting Vulnerable Workers* Bill, it runs an enhanced risk of making itself look as though it protects dubious franchise business models and operators.

In our view, any parliamentarian or advisor finding themselves being lobbied by the FCA on this matter, should reject the FCA's position.