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Attn: Dave Cobau

Submission to the Productivity Commission  
The Market for Retail Tenancy Leases in Australia

**A National Franchising Company (NFC) and A National Retail Management Company (NRMC) - Their Misrepresentations and the impact on us**

Dear Dave

Thank you for the opportunity to provide a submission to the Commission.

Background and Summary

My brother, Thurstan, and I were directors of Tauren Pty Ltd which entered into agreements that resulted in us operating a Franchise Store in an extension of a suburban Melbourne shopping center in September 2005. We had expectations of time commitment and investment commitment and profit in line with the projections provided by the Franchisor (NFC).

The entity structuring was complicated. The essential agreements were a Franchise Agreement with the Franchisor (NFC) and a License of the Lease between the Franchisor and a National Retail Management Company (NRMC).

Our business failed due to lack of foot traffic in the center and what we now understand is the fatally flawed NFC Franchise business model. Turnover was less than 40% of that projected by NFC and gross profit was insufficient to pay rent. Actual foot traffic numbers during our tenure have never been provided by NRMC as they refuse to release them.

We tried many ways of negotiating with NFC and NRMC, including attempts at mediation with the Small Business Commission. We were continually put off and ignored. We got nowhere near a sustainable result in terms of an ongoing rental agreement that would allow us to trade without making substantial losses for the term of the lease.

Eventually we refused to pay rent and were locked out of our shop in December 2006 by NFC acting in concert with NRMC.

We then spent considerable time and money (>\$40,000) preparing a case to take NFC to court for misrepresentation.

At mediation with the Office of the Mediation Advisor in February 2007 we sold the business back to NFC. We have been partly paid by NFC under the sale agreement

and are waiting for the final payment from them due this month. We expect a further fight.

Our losses as a result of entering into these agreements, and our legal fees to bring NFC to account, were in excess of \$250,000 direct cash plus consequential losses of \$150,000 as we had to fire sell assets to keep afloat. Further we have each suffered relationship stresses and health problems, including depression, as a result of this failed enterprise.

NFC currently operate the shop as a corporate store and have been unable to sell it to a new franchisee. We understand that trade has not improved under their management. Furthermore many of our neighboring tenancies in the center are now vacant and the tenants have gone broke. One has lost his life savings is divorced and living in a caravan.

Meanwhile, in other centers throughout Australia many other NFC franchisees are suffering large losses. Though each has different circumstances of lease and location the result is the same.

In late 2006 we and three other franchisees met with the ACCC and asked that they investigate NFC business activities as we believed they were misrepresenting, amongst other things, the returns possible from their franchise system and their skills in negotiating advantageous lease terms with shopping center landlords.

We provided substantial documentation to the ACCC and they interviewed NFC to see if they would conduct an investigation. Ultimately they did not investigate. They have proved themselves toothless.

At time of writing we are aware of a fifth franchisee that has also been locked out of his shop. This franchisee has now spent \$40,000 preparing a legal case against NFC and must now put up an additional \$100,000 in court costs to bring NFC to account. Benchmarking the financial performance of this shop against industry clearly shows that it cannot afford the rent and the NFC royalty.

#### Commentary and observations

1. When Thurstan and I first considered the NFC business opportunity we were well aware of the disparity in negotiating strength between small retailers and large shopping centers (and the reputation the landlords had for misuse of their power). We only proceeded because we believed NFC' representations that as a large franchise they had substantial bargaining power. Despite their representations to us that they would fight for us it soon became clear when the business started to fail that they would preserve their relationship with the landlords over their relationship with us. We accept that this is good business from their point of view and believing them initially was poor judgment on ours.
2. The ACCC findings (as per the attached letter) highlight the issue of who was responsible for making representations to us about turnover and foot traffic. Was it NFC or NRMC or both? In fact they both were responsible and it is a convenient confusion for them that would only make our legal case for

misrepresentation more costly and difficult to resolve. In fact this confusion of responsibility was a continual theme throughout our tenure at the center and contributed to many delays as we would attempt to negotiate with NFC and they with NRMC. Months would pass and nothing would happen. NRMC were expert at making us wait and dragging things out, all at our cost.

3. Despite being experienced in business and property transactions this was our first venture into a retail business. As such we were flat out learning about a new industry and the NFC business processes. Although we knew early on that the turnover was far too low it took several months for us to figure out that it was not our management/inexperience that was causing the failure but that we had been sold an absolute dud. Having realized we were in a poor situation we tried to negotiate with NFC and were continually told that NFC would work something out with NRMC and that we should hang on and that things would get better. They did not. Next we had to become expert in the complex laws around franchising and leasing and figuring out how we should go about calling for mediation. We attempted mediation with the SBC but NRMC would not attend so that was a useless endeavor and a waste of several more months. NFC would not call NRMC to the mediation table so eventually we had to turn our sights on NFC and undoing the relationship that we had entered into with such high hopes.
4. NFC and NRMC complied with the documentary requirements of the retail leases and franchising legislation. Ultimately we discovered that their figures were all fabricated and the risk and loss was all put to us. Our solicitor advised us at time of signing up that “they can’t just make up the numbers – it doesn’t work that way”. Our experience has been that it is so difficult, uncertain and wearying to try to get the money back that it is easier to just take the loss and move on. Many others think the same. The upshot for NFC is they have taken back the shop and we have worn the substantial loss for the first 15 months of operations and subsidized their shopfit cost. Whilst it is possible that NFC may be making a small loss at present they have bought the shop at a substantial discount and it is likely that NFC have renegotiated a lower lease with NRMC (now that we “feral franchisees” are not part of the equation) and they will be free to take profit from the eventual sale of the business when trade improves. The hurt is almost entirely ours.
5. At mediation NFC put the options to us very clearly. The reality was we had already lost ~\$200,000 during the year, our health and personal relationships were deteriorating, we had spent \$40,000 on legal fees to prepare a court case and we now faced the prospect of spending another \$100,000 testing very uncertain legislation (ref Silver Fox versus Lenards Chicken Federal Court case). Furthermore we would not have been able to derive an income whilst fighting the case as it would take serious attention. NFC clearly knew all this and pitched their offer accordingly. We took the business decision to sell, take the loss, and move on.
6. Thurstan and I are not large players but we did have some reserves that allowed us to put up a fight. Many small retailers do not have the resources, usually with large bank loans against their homes, and so are in a far weaker

bargaining position and so just walk away with nothing. NFC are backed by an “Equity Player” with massive cash resources. I do not believe it likely that with our resources versus theirs we would have won this battle in the courts. Even if we could have won the battle the time, work and stress it would have taken to get the win would have made it not worth our while.

### Recommendations

- There must be far more onus put on Shopping Center Managers (or franchisors or both) to provide ongoing reporting to the tenant and to make them accountable to their initial representations and to **promote dispute mediation process in all their communications** with tenants.
- Interference to tenant’s business by such things as introduction of other retailers or landlord construction works or discriminatory car parking policy should result in compensation from the landlord.
- Foot traffic
  - i. There should be a national standard for the calculation of foot traffic.
  - ii. Shopping center managers should be made to publish foot traffic through each door on a web based database.
  - iii. The figures should be regularly updated.
  - iv. The figures should be audited.
  - v. There should be standard lease conditions that rent and rent compensation be tied to foot traffic
- Turnover
  - i. Turnover of all tenancies should be published along with current and past lease details so that retailers can properly estimate fair market values and rents.
  - ii. All details should be regularly updated.
- The center manager (or franchisor) should be charged with the responsibility of promoting the mediation process to tenants (much like the cigarette packs telling smokers about cancer). The promotion should be via ongoing regular newsletters and review sessions, not just when a dispute exists.
- Franchisors and Landlords should be made to put up a cash bond as security against their performance versus their initial representations. This cash bond should be at risk at mediation as it is too difficult for small tenants to chase payment in the event that they can prove fault.

Yours faithfully

Rad Williams  
**Tauren Pty Ltd**