

Address to the Franchise Council of Australia' NSW Luncheon

Thursday 1 September 2016
Moore Park Golf Club

Slide 1 - Introduction

Good afternoon and thank you Sean for the invitation to present today.

It was in December last year that I presented to the FCA Board regarding the Fair Work Ombudsman's interest in ensuring franchises are compliant with workplace laws and more importantly how we can assist franchises in doing so.

One of the key points I made that day was to recognise that '**compliance costs**' but so too does 'brand damage' – indeed, even moreso.

We had a lively and honest session where Board members sought to know what the cost was, that is, could I provide a quantum – at the meeting, a member of the Board who's brand is in a compliance partnership with us, **La Porchetta**, was able to provide a dollar figure and talk to the significant benefits that have accrued since working with us.

Sara's contribution helped reframe the conversation as compliance not involving a cost but **an investment**. I concluded my presentation by saying a franchise can adopt a number of different approaches:

1. Ignore or deny the issue
2. Factor 'detection' into the cost of doing business
3. (Think you can) outsource the problem through a contract
4. Adopt a pro-active governance and management framework.

This is not an exhaustive list by any means but I have been asked in today's presentation to address the 4th approach and explain the Fair Work's compliance and enforcement program and in particular what is involved in a compliance partnership which is underpinned by a proactive compliance deed.

Slide 2 - Our role

The Fair Work Ombudsman is an independent statutory agency which has two key functions:

1. To promote harmonious, productive and cooperative workplace relations
2. To ensure compliance with the Fair Work Act.

These two functions are entirely complementary.

Indeed, the complementarity is one of the reasons why a key focus of the Fair Work Ombudsman is better understanding the relationship between the particular operating models of franchises and levels of compliance with the Fair Work Act – but more of that later.

Slide 3 - First principles and a case study

Let me begin with a first principle: - workers who provide their labour to a business are entitled to remuneration - in Australia, this principle is regulated and enforced.

In addition to legal obligations, the Fair Work Ombudsman has publicly and consistently asserted those who benefit from this labour have a moral and ethical obligation to ensure a worker's entitlements are met.

The franchisor may not be a direct employer but it benefits from the workers' provision of labour.

Put simply, legally and morally a franchisor cannot hide behind or outsource its responsibility to ensure lawful remuneration to a franchisee.

7 – Eleven believed it could – but no more – again, more of that later!

Our Inquiry found 7-Eleven's approach to worker remuneration, while ostensibly promoting compliance, did not adequately detect or address deliberate non-compliance and as a consequence compounded it.

Why did we conclude this was the case – well, the Inquiry found a high percentage of franchisees created false and misleading records to satisfy 7-Eleven's auditing and payroll regime but continued to underpay employees.

Notwithstanding the many years of warning we gave to 7 – Eleven's head office, the business consistently failed to look behind the documents.

So with 7-Eleven, they had good policies, they had good system and procedures – all compliant with workplace laws. But no one was testing what was happening in practice; **there were no controls.**

Think about other industries such as financial institutions where the policies and procedures were sound – but what was happening in practice was totally different. The controls were insufficient; the business was turning a blind eye. Here's the deal, the community cares about business treating people poorly. Your customers will care about you treating your employees poorly.

Our Inquiry has resulted in the following enforcement outcomes:

- seven franchisees before the Federal Courts in June, we saw a record fine of over \$400,000 against a franchisee in Brisbane

See the media release: [Record penalty against 7-Eleven operator who systematically exploited staff.](#)

- one franchisee in an Enforceable Undertaking with the FWO
- 20 Letters of Caution issued to franchisees
- 14 Infringement Notices issued to franchisees
- three Compliance Notices issued to franchisees.

And there's more enforcement activity to come as our investigations into serious non-compliance continue.

However, what I would like to emphasise today is our Inquiry examined what influence the 7-Eleven operating model had on franchisees and their behaviour.

In particular, we explored the drivers of non-compliance that originated in the 7-Eleven head office and impacted the entire 7-Eleven network.

What we found was for many years, 7 – Eleven, as a franchisor, had made a lot of money but its governance arrangements relating to remuneration were deeply flawed.

Celebrating yesterday its one year anniversary, (*The 4 Corners* episode on 7-Eleven was aired on 31 August 2015), Adele Ferguson reported in Fairfax press, the exploitation of vulnerable workers by an award winning franchise represents Australia's greatest wage theft scandal.

To date, 7-Eleven has repaid over \$26 million to workers and it is highly likely that figure will end up north of \$50 million.

The brand of 7 – Eleven has become synonymous with 'rip off'.

Sadly, 7-Eleven is not an orphan.

Slide 4 – FCA Member Response to FWO Outreach

In October last year, Kim de Britt, General Manager of FCA, met with Natalie James, the Fair Work Ombudsman and Michael Campbell, the Deputy FWO – Operations to discuss, amongst other things, how the FCA could work more closely with the FWO.

During this meeting Mr de Britt advised that a number of key members of the Franchise Council held significant concerns regarding the negative publicity that had attached itself to 7–Eleven following the airing of *The 4 Corners* program.

Mr de Britt also advised that of chief concern for all members of the FCA is the prospect that all franchises are being unfairly '*tarred with the same brush*'.

Mr de Britt expressed his confidence that FCA members are more than keen to work with the FWO to ensure and promote compliance with workplace laws and give the broader community greater confidence that their commitment to compliance is both sincere and real.

In response to Mr de Britt's comments about the willingness of his members to comply with their obligations, and to commit to them publicly, Michael Campbell wrote to 8 Franchisor CEOs advising we were keen to talk to them and / or their senior executive teams about entering into a Compliance Partnership with the FWO.

Just in case you are unsure what I mean by a Compliance Partnership – it is essentially a contract that a business or brand enters into with the FWO wherein the brand formally signs up to a number of commitments which are designed to advance sustainable self-compliance underpinned with workplace laws.

We term the contract which underpins the partnership a Proactive Compliance Deed.

The nature and content of a partnership deed varies depending on the brand and its compliance history but generally:

- there is a commitment to either implement or enhance systems and processes that promote compliance,
- an option to have a single Executive officer level point of contact with the FWO,
- the opportunity to self-resolve most types of requests for assistance that are made to the FWO by their workers, and, importantly,
- a provision for a self-audit of a reasonable percentage of their workforce, that is either completed or signed off by a recognised, agreed third party such as a Certified Practising Accountant or an Employer Organisation.

A partnership affords a brand an opportunity to work closely with the regulator in ensuring compliance across its operation.

If problems are found we can work through them together (and I will shortly highlight the benefits of that arrangement).

In order to enhance the prospects of a more positive response, Mr Campbell requested Mr De Britt email the CEOs commending the initiative prior to Mr Campbell sending his letter.

It is our understanding Mr de Britt did indeed email the 8 CEOs

I have to say the response we received was disappointing

So we followed up the letter with phone contact

Nearly 9 months on, the response rate looks like this:

- 1 engaging with us on a serious basis,
- 1 who politely but very quickly said *'thanks, but no thanks – nothing to see here'*, and
- 6 who have effectively chosen to ignore the invite.

Now these operations may well be squeaky clean and fully compliant – but experience tells us that at the very least they are likely to have some problems.

In fact one we know certainly has some problems because since our letter we have entered into two Enforceable Undertakings with its franchisees.

I would have thought after all the media around 7 - Eleven and the public reaction, these CEOs would have at the very least been interested in a meeting – if for no other reason than some basic brand protection.

Indeed, recently one of my Directors met with representatives from the franchisor whose franchisees are subject to enforceable undertakings and specifically asked what proactive measures the franchise undertook to ensure its franchisees were compliant with workplace laws.

The franchisor responded by saying that, apart from having it written in their contract, it was up to the individual franchisee to ensure compliance.

The very senior representative of this brand then said it *'did not fit their business model to get involved in the running of franchisees' businesses'*.

Wow – that's a risk approach which I would advise against – no matter how secure you think your compliance controls are – but I will return to that point.

Slide 5 – green shoots and positive signs

Meantime, I'm pleased to say it is not all doom and gloom in our interactions with franchisors.

We have several big brands involved in our Compliance Partnerships.

McDonald's was the first company to enter a compliance partnership with us back in 2010.

Such was the success of this partnership, McDonald's signed up for a second Deed - which has only recently expired - and we are confident we will enter into a third Deed as McDonald's have advised us that they would like to do it all again.

Throughout this time, we have seen the number of requests for assistance from McDonald's employees to the FWO reduce to a very low level, especially when you consider McDonald's employs approximately 100,000 (mostly young) people across the country.

And during this time of partnerships, McDonald's profits have been strong which we take as a good example that a business can comply with their legal obligations towards their workers and still make money.

Indeed, this is further highlighted by Domino's, another of our Compliance Partners.

Domino's are currently nearing the completion of its second Compliance Partnership and its share price has just hit a record level – I'm not saying correlation is necessarily a cause.

Naturally, issues still arise in McDonald's and Domino's outlets but because these franchisors have a strong commitment to compliance with workplace laws, they have processes in place to fix them and put in place measures to ensure they don't happen again.

And by working closely and openly with the Regulator we have more confidence in what they are doing than we do with other brands that come on our radar.

Another good example of the benefits of working closely with the regulator and of being a franchisor committed to protecting its brand is MDKL – whose brands include Coffee Club and Groove Train.

MDKL franchisees had been a regular source of business for us before 2014.

When they demonstrated their commitment to compliance to us in early 2015 we were pleased to enter a Compliance Partnership with them.

Sure, they still have troublesome franchisees, but MDKL is working to either make them compliant or to have them leave the network and replaced with compliant businesses.

One Friday afternoon last year 3 visa workers called into our Melbourne Office to complain that they were working hours for an MDKL franchisee and not being paid. We offered to take a formal statement from them but, not uncommonly for overseas workers, they were nervous about lodging a formal request for assistance and told us they would think about it and come back the following week.

Because of the relationship we had developed with MDKL, and knowing they would not tolerate this type of behaviour, we rang MDKL and advised them that we had just heard these allegations against one of their franchisees. We stressed that they were only allegations and we had not proof.

To their credit, and in a clear sign of their commitment to compliance – and brand protection – MDKL immediately undertook an investigation and the next week the 3 workers presented at our office again to advise that they had been paid in full for all hours they had worked.

This shows us that MDKL are serious about compliance across their network – and about brand protection.

We find in all our dealings with franchisors that the franchisees that cause us grief are normally causing the head franchisor grief over a range of issues. That is, rogue franchisees rarely only misbehave in relation to their workplace relations obligations.

MDKL is no different.

We have had to undertake investigations into a couple of their franchisees and MDKL have supported us all the way. They want to stamp out illegal behaviour in their network as much as we do.

Work with us and show a commitment to compliance and we will work with you. But if you go it alone, and constantly fall short, we will expose you.

We fully appreciate that, for a range of reasons, Compliance Partnerships are not for every brand.

You may be doing all the things we set out in a Compliance Partnership and if you are being successful, more power to you.

But if you think there is a chance your brand could be exposed and there is more that you could do to ensure compliance across your brand then we are happy to talk to you.

Whatever you do, don't adopt the position of our friends I mentioned earlier who said that ensuring compliance across their network was not built into their business model. They are basically saying that brand protection is not on their agenda - and not many brands can afford that in the current climate.

Slide 6 – Diverse Accountabilities

I'm not sure how many of you subscribe to Journal of Industrial Relations but in their February 2016 edition, the Journal featured a very interesting piece on *'regulation of and compliance with industrial relations in franchises'*.

The article was co-authored by 4 academics of Griffith University and is the result of a study of three (3) similar Australian owned food service franchises – the report maintains the anonymity of each franchise.

The franchises were mature (established over 20 years ago) and the majority of outlets were small businesses employing between 10 – 30 employees on various types of contract (full time, part time and casual).

The authors start with the recognition that franchises exist in the context of the transfer or risk from capital to labour – in particular, the authors note a key element of costs in a franchise is of course employment costs.

That is franchises are specifically designed as an organisational structure that transfers risk from the franchisor to others, that is the relationship between a franchisor and an employee is different to the relationship between a franchisor and a customer.

The following part of my presentation has been lifted from the article as I believe it describes the essential operating model of a franchise and why we at the Fair Work Ombudsman are so interested in exploring the relationship between the business model and any non-compliance with workplace laws.

'The customer usually cannot know whether the outlet from which they are buying is company-owned or franchisee-owned, so they attribute the product characteristics to the franchisor.

*If they do not like their muffins, they will cease buying from that outlet, and also likely cease buying from **all** outlets thus branded. In that sense, both the owner of the outlet and the head office of the franchisor are accountable to the customer.*

'It is therefore in the interests of head office to maintain tight control over product quality, and create mutual obligations and information transfers via the franchise contract.

'The employment relationship in franchises is different.

'It is the owner of the outlet - the franchisee - who is accountable to the employee for compliance with legal obligations.

The head office franchisor is not usually directly liable. Moreover, while franchisors seek to maintain control over product quality, they also seek to do so at the lowest possible cost, and this achieved partly through, in effect, contracting out employment. Thus it is in the interests of franchisors to put in place systems (such as turnover-based payments) that create incentives for franchisees to operate at the lowest possible labour cost'.

The authors go on to make a few other key points in this article worth highlighting:

- Compared to items such as quality, marketing, opening hours, presentation, reporting, finances and training, detailed references to employment-related requirements in franchise agreements are **uncommon**.
- The franchise business model allows the franchisor to take advantage of the structural differences between franchisees (which typically have small business characteristics such as low unionisation and low labour costs) and franchisors (which exhibit HR characteristics typical of large organisations such as prescriptive rule making), *'reaping advantages from control over product and processes of a large organisation while extracting some of the rents accruing from the low-wage and low-compliance model of small business'*.
- Franchisors will give **less support** to franchisees on IR matters than product-related issues.

The authors' focus on the operating model is key – it is the same focus the Fair Work Ombudsman has – and why in the 7-Eleven Inquiry Report we made – amongst many - the following recommendation, namely, the need for 7-Eleven to:

*(Take) steps to improve the employment practices of its franchisees by implementing **fundamental, permanent and sustainable changes to its franchise model** to ensure workplace relations laws, including the Fair Work Act 2009 and related instruments, are fully complied with for all employees in each of its franchises.*

Slide 7 – Accessorial Liability – Section 550 of the Fair Work Act

The *Fair Work Act 2009* continues the customary approach of centuries of labour law, which is that the legal rights and obligations of an employment relationship lie with the employer and employee.

However, the Act does enable the extension of liability for contraventions of workplace laws to persons who are an accessory to those contraventions.

Specifically, section 550 of the FW Act provides that a person who is ‘knowingly involved in’ a contravention of a civil remedy provision is taken to have contravened that provision and is exposed to penalties and other orders flowing from that contravention.

A person is ‘involved in’ a contravention if they:

- aided, abetted, counselled, procured or induced the contravention
- conspired with others to effect the contravention
- were in any way, by act or omission, directly or indirectly, knowingly concerned in or party to the contravention.

You may have read in the media that we are seeking a range of orders against a frozen yogurt outlet, Yogurberry, in the World Square shopping centre in Sydney's CBD.

We are alleging that four Korean backpackers were underpaid a total of **\$17,827**.

We are taking the employer to court – but we are also seeking orders **against accessories** through the franchise network – the head company and master franchisor, the payroll company and a manager of the head company for their alleged involvement in the underpayment of subclass 417 visa holders at the World Square outlet.

This builds on our earlier work using accessorial liability in trolley collecting supply chains, where we have used the provisions to hold the beneficiaries of the labour – big supermarkets – accountable for exploitation of their contractors’ and subcontractors’ workers.

In Yogurberry, we are seeking to leverage the accessorial liability provisions of the Fair Work Act by asking the court to place some strong obligations on the head company– requiring a professional external audit of all of the stores throughout the entire retail chain.

We are also seeking an order requiring head office to commission workplace relations training for their managers.

We have sought these orders because we believe the underpayment problems are more widespread than just the World Square outlet. Action confined to that outlet, on its own, is unlikely to build a culture of compliance in the entire franchise chain.

Seeking a broader range of court orders against accessories as well as corporate employers allows us to tailor our response to the circumstances of each employer and accessory that we take to court.

Slide 8 – Getting ahead of the curve

In commending the JIR article to you, I encourage you to get ahead of the curve in terms of what is happening around franchise regulation.

The Fair Work Ombudsman is seeking to change behaviour and build sustainable compliance within workplaces.

And the main driver for our actions is to create a level playing field for all businesses in Australia.

We repeatedly hear small business owners and operators saying 'just tell me what I have to do and I'll do it and then leave me alone to compete'.

It is simply not fair for employers doing the right thing to struggle to compete against employers deliberately doing the wrong thing.

No doubt you have noticed that in some of our press releases, we name parties other than the direct employer of workers.

When we find exploitation of vulnerable workers, it is our standard practice to examine who is the ultimate beneficiary of that exploited labour and what is the role of that beneficiary in the exploitation?

The way the market works is the company at the top of the supply chain, or at the head of a franchising network, is often controlling the settings, including how much money is going into the supply chain or indeed in the case of a franchise being extracted from the network.

In some parts of our labour market, I'm afraid to say, non-compliance with workplace laws has become a cultural norm.

Indeed, just last week (25/8/16), in The Australian Financial Review, Michael Smith, the Chairman of 7-Eleven, wrote an opinion piece where he said:

'The reality is underpaying workers is not confined to just one company or one industry. It is occurring across the Australian economy. The extent of workplace compliance failure is leading many participants to believe such practices are the norm, resulting in low complaint levels that mask the breadth of the problem'.

Michael Smith is right and can I take this opportunity to commend Michael and the new management at 7-Eleven which is committed to introducing a new culture of compliance.

I'm pleased to report that since the release of our Inquiry report we have held numerous discussions with 7 Eleven about entering into a formal Compliance Partnership with us and 7-Eleven has responded positively and constructively as it sees this invitation from us as a great opportunity to implement appropriate systems and processes across its operation which will achieve sustainable self-compliance.

We are at an advanced stage of our negotiations and hope to make a positive statement publicly in the next few months.

But back to Michael's key point – the contemporary culture of non-compliance.

The common characteristics of exploitation are: low-skilled work, price-driven procurement, a proliferation of entities in the supply chain or network, tight profit margins and vulnerable, often overseas workers.

But even if you are, on balance, comfortable with the legal risk your company or client is taking on, that's not the end of it.

In closing, I encourage you to think beyond your narrow legal risks to brand and reputation.

The community expects better.

The community reaction to hearing that franchisors are benefiting from exploitation is swift and strong.

The community expects business to take responsibility for its labour, regardless of where strict legal liability begins and ends.

Every week, my people sit across the table from the Corporate Counsel or Human Resources Managers who are adopting a 'heritage' narrow legal focus – thinking they can behind a pile of carefully written contracts.

Such a posture is a key risk now and even more so in the future when we consider the Government's election commitments.

If you work in a franchise – as an owner, adviser or manager – are you doing enough to ensure that what is happening in the business is lawful?"

In the recent election campaign, the Government committed to making a range of changes to the Fair Work Act.

In response to the 7-Eleven Inquiry, the Government has committed to new laws that capture franchisors and parent companies that fail to deal with exploitation in their networks.

It is not enough for the Franchising Code to be amended to allow a franchisor to terminate the services of a non-compliant franchisee.

In building a culture of compliance, the Fair Work Ombudsman is committed to identifying and addressing the drivers of non-compliance that may emanate in the franchise's operating model – the specific terms regarding profit sharing that control the franchisee's ability to both make a profit and be compliant.

The Government's policy also commits to strengthening the Fair Work Ombudsman's compliance and enforcement powers to allow us to **compel employers and other witnesses to produce information or answer questions**, subject to appropriate checks and balances.

This will greatly assist the Fair Work Ombudsman to source the evidence it needs to take employers and accessories to court.

Governments do not introduce changes to laws like these if they don't fully believe that the public, that is, your customers, will accept them.

Hopefully, the announcement of the imminent introduction to Parliament of these new laws – one year on since the airing of the 4 Corners expose of 7-Eleven - will help to change the attitude of some head franchisors about the investment required into ensuring compliance.

I started by saying 'compliance costs' and it does but recovering your brand reputation costs a truck load more – if you don't believe me, ask Michael Smith at 7-Eleven.

Happy to take any questions.