

*Outlaw gag orders. Outlaw gag orders... This is about power, plain and simple...*

The Legislative Assembly of Ontario  
Standing Committee on Regulations and Private Bills  
1st session, 37th Parliament  
Toronto, Ontario, Canada

## **Public Hearing Testimony**

FRANCHISE DISCLOSURE ACT, 1999  
*Consideration of Bill 33, An Act  
to require fair dealing between parties to franchise agreements,  
to ensure that franchisees have the right to associate and  
to impose disclosure obligations on franchisors*

Tuesday 7 March 2000  
Location: Sault Ste. Marie, Ontario

**Expert Witness: Mr. Les Stewart, Canadian Alliance of Franchise Operators**

The Acting Chair: The next witness will be the Canadian Alliance of Franchise Operators, Mr Les Stewart. Mr Stewart is an expert witness. Welcome to the committee, Mr Stewart. We have a period of time to spend together here, 45 minutes.

Mr Les Stewart: Thank you, Your Worship, Madam MPP and gentlemen.

The Acting Chair: He's the Worship; I'm the gentleman. But I appreciate the respect, because I don't get a lot of it.

Mr Stewart: I'm sure it's more than earned.

My name is Les Stewart. I've come to speak to you in the manner that I think one of the witnesses yesterday, David Michael, spoke to you. As you recall, David was with the Pizza Pizza franchise system. I hope to be able to go through a good deal of information and leave lots of time so that I can fill in the blanks.

I am first and foremost a businessperson. I have had training in business. I have an operating business in the Barrie area. I have 780 customers who seem to like what I'm doing in the lawn care business.

Please excuse me for being nervous, but it has been quite a few years. If I might go through a bit of personal history, I received my BA and MBA at the University of Western Ontario in London. I have extensive McDonald's restaurant experience, starting when I was 13 years old as a crew member and culminating in 1980, when I was first assistant manager in the Orillia McDonald's. At that time, I was employed by a franchisee who owned the Barrie, Midland and Orillia McDonald's. At that time, the ownership changed from that franchisee to McDonald's Canada Corp. That happened at the same time the Midland McDonald's was being certified as a union. From there I went back to finish my BA at Western. For three summers during the time at school I was a painting contractor; I ran a painting contractor business in Barrie. I worked also during the summer of my business program as a real estate researcher for a fellow who owned 28 Harvey's and Swiss Chalets out of Sarnia. We were successful in developing the real estate work to get five new stores going within the year.

I was also a medical audit coordinator at St Thomas Psychiatric Hospital after school. I learned that if you are going to start looking at medical records and dealing with physicians, psychiatrists, psychologists, you'd better have their trust. As a president of the only franchisee association in

Canada, that is all I have: the trust of the people who have experienced franchising. The sound that you hear is the sound--the silence--of all of the successful franchisees in this country who are saying: "Mr Stewart, the message you are bringing here today is wrong. There's nothing wrong with franchising." I am not contradicted in my assertions by operating business people who have extensive knowledge of franchising.

What prevents them from communicating are a number of things that we will go through, but the only thing I have--CAFO, the Canadian Alliance of Franchise Operators, is my hobby. I have subsidized this for two and a half years from the operation of my business, and to anyone who thinks this is a money-making endeavour, I have the net worth to prove it.

I was a financial analyst for three years at Victoria Hospital in London, which is a large teaching hospital with an operating budget of \$350 million a year, so I have some experience in financial matters. I was laid off from that position in March 1992. I conducted a traditional job search for nine months in an outplacement program at Price Waterhouse in London. I signed a franchise agreement after what has been deemed at trial to be the most extensive due diligence the judge has ever seen. I signed that franchise agreement one week before my unemployment insurance benefits ran out.

So what happened to me in my franchise? I operated it for four and a half years. The first two years I lost \$130,000. I achieved less than 25% of my pro forma income statement revenue. I am a fourth-level CMA, certified management accountant, and I have seen, in the four and a half years of the system that I was involved in, 17 ownership changes in the 24 markets that are served in Ontario by this lawn care franchise.

If it were just me, I would never be here today. But in the process of trying to find out what the devil happened, because first I had to explain to myself and then I had to explain to my wife and mother why she needed to mortgage the house after having it mortgage-free for 20 years, I needed to understand why. That is just all this is, an inquiry into understanding of, why the devil does this happen? Why do hard-working, bright, competent people get themselves into a situation where it seems that there is almost a system to strip life savings away from you?

After four and a half years in a small business, cash is king. Working capital is the only thing you can't borrow. You have to either put it in equity, or through the profitable operations of a business you increase your working capital. The cash ran out. Their solution was, "Just get your mother to put in another \$50,000." I said, "No, this is enough after four and a half years." They said, "Well, I guess you've got to sell."

I tried to sell it for nine months. I received an offer for \$35,000 two days before the injunction hearing. That was for a business that was listed and worth--and the franchisor agreed--\$171,000. When I represented myself in the Barrie courthouse for the request by the franchisor to stop me in the lawn care business, the judge said, "Mr Stewart, isn't half a loaf better than nothing?" I said, "Absolutely, and if I had an offer that was anywhere close, I would have gone." The judge looked at it and said: "You owe them some money for product. Pay them, and let's let the lawsuit carry on." I have been engaged since February 1998 in a legal battle with a \$350-million-a-year company. They control the trademarks of six franchise systems and at last count, when I checked their Web site, they have 1,600 franchisees. I am an example. It's not about money; it's all about control. I'm the one who just wouldn't go away.

I started the Canadian Alliance of Franchise Operators simply because I was trying to figure out what to do with myself. I tried to gain some assistance. I did everything by the book. Some people have characterized me as a bit of a Boy Scout, and that's probably true. I am a product of central Ontario, of a small community. I have gone on and received an education to become a productive member of this society. I have been involved with a system that has destroyed me financially and will probably win. As my wife and I started to gain understanding of this--when I say "my wife and I," I want to make this very clear: These are family businesses. Anybody who wants to elevate this to the level of Time Warner and AOL is trying to sell you something. What they're trying to sell you is that it's OK. The gentleman to my right in the back of the room will tell you: "It's OK. What's the problem?"

The stories I was hearing from the guys--my bookkeeper lost \$50,000 in a gas tank franchise system. My largest customer lost \$60,000 in an asphalt paving franchise. When you start looking at these things, and you've gone to school, you start saying: "What's going on here? Does everybody have to deal with this in this way?"

I went through the injunction in Barrie. I represented myself, the most frightening thing I've ever done.

I've run a McDonald's effectively: a 35% sales increase, an AAA rating, the highest McDonald's can give. I have gone through an MBA program at Western, and I know pressure. This is nothing compared to this. If you control a man's economic life, you control his will.

My wife and I made one decision and that is, we will not lie to take the short-term, easy solution. What I have done here, working with Tony and a small group of people, is simply because I believe it's true, and I can prove it. As I'm sitting here, if it weren't true, the avalanche of statements of claim from this industry would just crush me, because I am a vocal advocate for billions of dollars of franchisee investment. But they have had their tongues cut out by the perversion of civil law. There's nothing civil about this law. It's being used and twisted to extract the last nickel from a dying man.

Some of the truths that I've come to understand: Franchises are bought and sold as a consumer good; they are not a business-to-business relationship. I've brought a couple of examples of the trade magazines. When you start talking to people about their dreams and "the freedom to be what you can be," you are not talking to Sam Bronfman; you are not talking to skilled people. You are talking to people who got laid off from Molson's and are looking, this fall, at having a \$200,000 payout after 20 years in a brewery. If you don't think the blood's in the water and that inexperienced people are going to have that problem solved for them in that they've got too much money, then I think--it's a word that I've gotten to use because I hang around way too many lawyers. It's called "disingenuous."

Where I come from, when you know something, you have responsibility for it. If I tell you something, you have responsibility. It seems that there is not much responsibility in this industry over a period of time. There is a pre-sale veneer of free enterprise and competition, market-driven. That is a veneer. As soon as you sign a franchise agreement, you're in a monopoly situation. Franchisees need protection at the time when they can afford it the least, and that's no coincidence, by the way.

As a responsible father, as a responsible husband, I did everything I possibly could do, and I probably invested too much money in a system that wasn't particularly predatory, when you compare it to everybody else. It was just incompetent. They didn't know what they were doing. But it doesn't matter. It doesn't matter if you're predatory or you're incompetent in the behaviour that you exhibit, because it's not your money. It's other people's money.

Franchising in a business administration sense is just--Wal-Mart is not franchised. They own all of those stores and they seem to have done pretty well. Franchising is just a way of raising capital, that's all. It's a way of raising capital and expanding the system quickly, and it also avoids all the security laws.

When people say franchising is extremely successful, I say: "Yes, you're right. That's true. But it's the distribution of that success, it's the allocation within the chain, between the franchisor and franchisee." That's the issue: It's the relationship. It is what happens, where you find yourself, the decisions you have to make. Control tactics are used within the relationship, the greatest being fear and divide and conquer.

People buy franchises because they're afraid. They're afraid that they won't be able to feed their family. They've been laid off, they are out of school, they don't have experience. People look for a solution. Within the relationship, it's fear of losing everything you've put in, your sunk costs, being trapped by your own decisions. Afterwards, it's fear of being prosecuted by some of the gentleman you saw

yesterday. It's the fear of the letterhead from the law firm in downtown Toronto. It's the fear that "we are going to bury you alive."

I have seen good people, very good people, not be able to speak. How can you deny a part of your life? It's like not being able to speak of a death or not being able to associate with people to understand that you're not alone.

The people I deal with are at my kitchen table. They're invited into my home, because that's where the truth about franchising comes out. Only franchisees add value to the economy. Everybody else is overhead or parasitic. Lawyers are parasitic, the industry is parasitic, salesmen are parasitic. It's the capital. In an economic sense, we are the ones who add or subtract from the economy. When you are in a relationship and you are afraid, you don't invest any more money in that relationship, in that activity. I am a specialist in fertilizing and the control of pests and weeds. When I was a franchisee, I withheld any money I possibly could because I knew it could be stripped away from me. It is not good economics, and Gillian Hadfield will talk about that tomorrow.

The fundamental thing in franchising: franchisees provide the money; franchisors control the money. That's the fundamental issue in franchising and that's where the opportunity for abuse comes in. Not that every relationship is abusive; it's the opportunity to strip that away. Not everybody robs banks, but we have laws against bank robbery.

Lawyers are more of a hindrance than a help and the reason for that is because 95% of all the legal work in this industry is bought and paid for by the franchisor. It's their contracts, it's their loopholes to close up. They are the ones who spend money; they're the ones who have repeat business. I'll never buy a franchise again. My lawyer will only see me once, but if he were predominantly a corporate lawyer--he has a referral business, a reputation. He knows how to get these guys. He knows how to write the tough contracts, the 85-page contracts. He knows how to write those letters. That's his job. That's the franchisor's job, to write those letters and, in a sense, act as the goons.

What I've seen would absolutely chill you. I don't think it's an overstatement to say most motorcycle gangs have better internal discipline than some of the systems that I have seen. They have discipline only because they know they've got to keep it out of the newspapers.

The only thing I have ever had is the protection of the law--and a very unusual lawyer--and the free press, because if it's true and I can prove it, I am safe. But all of us around this table know that only goes so far. I have my telephone swept and I get the threats on the phone and I hear about people getting physical threats. This is an extremely good model for making money--brilliant. There are some brilliant minds at work.

The important thing in this industry is image--the only thing. I've sold things a bit in my life and I suggest everyone around this table has too. What I'm selling is an idea, but what you need to do is to say: "Look, do I trust him? Does he seem credible?" If you're going to accept my idea, that's the first obstacle. If I can't overcome that, then we can't do business.

The selling image of this industry is extremely well managed. They dislike any kind of questioning of their success rates. They dislike doubt. When you're selling someone and their life savings are on the line, and they know it, believe me, salesmen who are on commission at trade shows do not like the message I bring. It's not because I bring the message that franchising is all bad, but what I bring is that fundamentally there's an imbalance. Right now, people may be making good money in a franchise and all I want them to do is to say: "Can you please put it in writing that you can guarantee me that it's going to make good money next year, the year after and the year after that?"—because you've put \$3 million into your grocery chain. Can you guarantee me that or could any franchisor guarantee it?

The markets change. I'm aware of that. I love competition. I love beating the brains out of the Weed Man, taking their customers, and I do that by offering superior service and quality. I do that by

supporting my community. I don't do it by holding my customers hostage and forcing them to be my customers.

Lawyers: Franchisees are rotten customers for lawyers. We're chippy. We don't like lawyers. They're expensive.

Franchise systems: The gentlemen you heard yesterday, with the exception of a couple, represent franchise systems. What I would like to know is, where are the principals of the major franchise systems? Why aren't they here? They've sent the gentlemen behind me. But if they're such free-enterprise, market-driven people--you know, "Let the buyer beware and let's go. We want to be able to do this, a level playing field." If that is true, then why are they in Toronto waiting for the phone calls that are going to happen when we have a break here? Why aren't they here? Because they don't like scrutiny. They don't like independent questions. They don't engage in games that aren't fixed.

As far as dispute resolution, the way it's resolved is that franchisees go broke. That's how it's resolved. You can't afford it any more. An injunction costs you \$10,000 to \$15,000. A trial is going to cost you \$30,000 to \$50,000, if you're lucky. To be able to say, "You have the private right of action," when you have no money is just like saying, "You have the right to be a millionaire as long as you're not bankrupt."

The bankers always get paid. That's a bit of a truism, but certainly small business loans are primarily what are used to finance franchise leasehold improvements and assets. I was told to my face in a meeting with a director of one of the very large banks in Canada that franchising is the most lucrative form of commercial lending. When I asked him, "Why is that?" he smiled, and I said, "Could it be because the franchisor always guarantees that your debts are covered when he transfers it to the new owner?"

This is extremely lucrative, and you can really tell by looking in the trade magazines. Just look at the back page. The people who are paying \$5,000, \$10,000, are the banks and the banks know all about this. You ask any regional bank manager in this province if he's had horror stories with franchisees and you'll get an honest answer, but you don't get the same kind of answer on Bay Street.

In franchising, a fraction of a law is worse than no law. Let me explain that. In the US there is an FTC rule and it says that a franchisor can disclose, "We take all the rebates and the discounts; they belong to us." If you sign the agreement with that disclosure document, then if you're being charged, say, 500% above the market rate for your products from the franchisor, or you're getting rebates, when you take that to court, the judge generally says, "You said here that he gets all the rebates and discounts."

What I'm afraid of is that there we're going to create a law that gives the illusion of a solution so that the salesman at the trade show can say: "Ah, see this law? We can't do that any more. We can't be unfair. You have the right." I'm not sure if the salesman is going to also say, "But you'll have to have \$50,000 to take it to court to prove it yourself." The onus in Bill 33, in large measure, is on the franchisee to prove damage. The franchisee is in no economic position, in most cases, to do that.

When I talk about this I differentiate between the single unit franchisee--the normal guy--and the multi-unit, larger economic interest. Most franchises are sold as a consumer good to consumers, people who have never been in business before. They are the ones who are going to have to shoulder the great amount of weight of enforcement of Bill 33 if it were to go without any amendments.

When I talk about what we should be looking at in franchising, there are six elements:

We would be looking at how open or transparent the process would be, like an ongoing relationship.

That it's accessible to people, that it's sort of auditable in an accounting sense. It's not behind closed doors, like the deals aren't done in the back room.

That's it's flexible, that we can deal with things in the future.

That it's reciprocal. I don't think franchisees are asking for any more rights than the franchisors already benefit from. The rights should be reciprocal in a partnership.

That they should be portable. We're signatories to international trade agreements, and I think we should learn from other constituencies, other jurisdictions, internationally.

It should be measurable. I've learned in business and at school that if you want a result, an outcome, then you'd better measure for it. If you don't measure for it, you'll never get it. If you're not looking for a profitable business, then you will lose money. You have to measure things.

I have before you a schematic called the Franchise Life Cycle. What I've attempted to do is show you the actual elements that occur before and during the relationship of franchising. This is based on my experience and the experience of hundreds of franchisees I've talked to. I've vetted this with most of the experts on the franchisee side. It's a bit of a working document.

Once you've signed the agreement you have entered into a hidden world, a world that is certainly never disclosed to you. If you have a positive response, then that's terrific. You sign the next franchise agreement and the franchise agreement after. If you have difficulty, though, your alternatives--and sometimes you can control this and sometimes a franchisor controls it--the three alternatives are to abandon your business, to transfer it, or to go independent. Those are the only three ways out.

Everything is geared for you to transfer. Very few franchise businesses go bankrupt. It's in everyone's interest to keep the store going because of the high cost of litigation, the threats of the new money you would put in. What I have done makes no economic sense whatsoever. In the situation I was in, I should have transferred to the next owner, taken the \$35,000 and walked away with \$80,000 worth of debt. That would have been the best economic alternative when I was faced with it.

The next sheet is a number of references.

The reason we are here is that I believe we have been successful, to a degree, in being able to gain access to the media. That chart, Published Franchising Articles, gives you an indication of what has happened. These volumes certainly aren't complete. This is my best effort to document the 4,629 franchise families whose stories have been so egregious that they've been able to reach the pages of the Toronto Star, the Globe and Mail and the Report on Business.

I believe we have an industry that is sadly in need of a new image, and the image is this law. I believe the franchise industry is coming to Queen's Park, coming to our democratic system, and what they want to do is use elected officials to save, to paper over, a deeply troubled industry.

I believe that if there are no problems, then what's the problem? If there are no problems--am I an unreasonable gentleman? I'm a businessperson. I make no money from doing this work. As Dave Michael says, "This has been put on me." I tried to do the best I could as a businessperson. It's not the result I expected, but that's what happens in business. But if you are playing a game of cards, shouldn't it be a full deck?

All I can do is provide you and Tony the information and put it in your lap and say, "Here's the information that I understand to be true." It is your responsibility to act on the information presented to you and to formulate public policy. I hope we can move towards that in a collegial manner, because I believe there are overarching needs here, pressing needs.

I'm not interested in history. I'm interested in the future, in what I can do and what I can bring back to the 40,000 people who are in this quandary right now. Those are the people, the \$6 billion worth of investment, the 40,000 families, the 600,000 employees--they're franchisee employees; they're not franchisor employees. I write the cheques. I always look to see where the money comes from, who is

writing the cheques, who is opening the doors in the morning. It's guys like me. It's not guys in downtown Toronto.

The Acting Chair: Thank you very much. That leaves us about eight minutes, about two and a half minutes per party. We'll start with the NDP.

## Questions

Mr Martin: Thank you very much for coming today, Les. I think it's important to put on the record right off the bat, so there's no misunderstanding, that I've worked with Les for about two years now, with the present government, preparing for the series of hearings we are having this week, so that the story could be told and, at the end of the day, we could do something helpful for Les and others like him in franchising who simply want to be good business people, as he has shared with us is possible if there is a level and fair playing field.

Les, this package you put together, which represents, as you said, some 4,600 families, is actually just the tip of the iceberg of stories of franchisees who have been damaged in this province alone, over only some five or seven years. In it, you have been quoted in a couple of articles that have been written. One of them is from the Globe and Mail on June 16, 1998, on page B14, if anybody has been able to lug them along on this trip. You say: "This legislation is a 10% solution. If they think this is going to clean up the industry, they're wrong." Could you elaborate?

Mr Stewart: The information provided to you before you actually sign is carefully crafted. The salesman explained very clearly what you can and can't tell a candidate. Yesterday Susan Kezios explained that 30 years of disclosure regulation in the US doesn't work, and the reason is that the salesmen are very good. They are good salesmen. As Mr Levitt said yesterday, they can sell around a disclosure document.

What will happen is, through your best efforts you will provide what in good conscience you feel will be a solution or recommendations for it after first reading. That will be immediately gamed by the industry, "How do we get this?" That's what the industry trade associations are for, to figure out how to get around it.

The Acting Chair: Parliamentary assistant.

Mr O'Toole: Thank you very much, Les. I was looking forward to your presentation. I'm sorry I had to move out a bit, but I'm quite taken with your commitment to this thing.

You say it is a 10% solution--and these are more statements than anything in response to your position. I can assure you that I believe we are trying to find some balance. A 10% solution might be a bit critical. I don't want to refer to you in the Boy Scout mode, like the world is ideal. Forget it; it isn't. Sorry for that awakening here, but the judge said the same thing to you. He said half a loaf is better than no loaf at all. I'm not trying to be harsh on you. You have to realize that the only thing that's perfect is that one plus one is two, and beyond that it's a bit of a binary situation.

Can you suggest one thing within the framework we've defined that would improve--not totally correct; we've passed that, we're not astronauts--but one thing we could do that would make a real impact on these 40,000 victims, self-imposed victims in some cases? What could we do?

Mr Stewart: Outlaw gag orders. Outlaw gag orders.

Mr O'Toole: Wouldn't the right to associate--you now have an association, and you could probably be the president of it, where these people can all get together and say, "These are the do's and the don'ts of buying a business." Actually it's buying a job; it's not buying a business.

Mr Stewart: If it's buying a job, then there should be labour laws, Mr O'Toole.

Mr O'Toole: For the employer.

Mr Stewart: The employee, too.

Mr O'Toole: Well, agreed. I don't disagree with that. But I'm saying they are buying that. That's what their investment is trying to do.

I guess I'm trying to say: Do you think the right to associate would in some way help that or at least be the first good step in that direction--for instance, the experience you could share with them as a seminar leader. You could be a guest speaker at some of these workshops.

Mr Stewart: I'd love to be able to do that.

Mr O'Toole: I'm sure you would.

Mr Stewart: And do you know how many would be able to show? Exactly none. There's an article in here that appeared in the Toronto Star and it said, "Les Stewart loses." That was faxed. In your first in camera session you heard from a system and the lawyer just before that--that was faxed to those people. That was a message: "Do not touch Mr Stewart. Do not get close to him. If you get close to him, I'll set up a retail outlet right next to you and charge half the price, because I have that right." This is about power, plain and simple.

Mr Brown: Thank you, Mr Stewart. One thing you make very clear is the inequity or the inability of legal systems to deal with these questions, in a way. Obviously, he who has the gold can afford the lawyers. In the American experience--and I'm not very familiar with that--often many of these things can go on contingency, which isn't permitted in Ontario. Has that, in the American experience, assisted franchisees in any way in dealing with the franchisors?

Mr Stewart: I certainly think the issues of contingency help in the US system. Also, there are a lot more jury trials with franchisees, and the courts will issue punitive damages as opposed to--it's like they want to send a message to the franchise community, so they will say, "Yes, you've had \$150,000 in damages, but you get \$500,000 in punitive damages," as a message to the industry to stop doing that. That's done through a jury trial. That's why franchisors in the US don't like juries. In Canada, it's almost impossible to get a jury trial.

Mr Brown: Due to the expense of getting the case that far?

Mr Stewart: In Canada, the courts have generally been a great deal less willing to understand franchising, the unique relationship, because it is not employer-employee and it's not independent contractor. It's a hybrid, in the middle. The courts understand what's written on the piece of paper, the four corners of the contract. Gillian will talk about that tomorrow. If it's not on the piece of paper, it doesn't exist, in most courts' interpretations.

The Acting Chair: Thank you very much for appearing in front of the committee. We appreciate it.