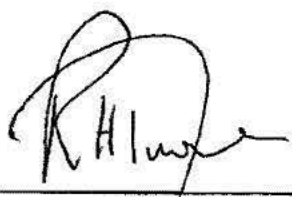

GENERAL NOTICES

NOTICE 186 OF 2011

DEPARTMENT OF TRADE AND INDUSTRY

CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, No 71 of 1988

I, Dr Rob Davies, MP, Minister of Trade and Industry, do hereby, in terms of section 10(3) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), publish the report of the Consumer Affairs Committee on the investigation conducted by the Committee pursuant to Notice 291 of 2010 as published in Government Gazette No. 33073, Volume 537, dated 31 March 2010, as set out in the Schedule.



Dr ROB DAVIES, MP

MINISTER OF TRADE AND INDUSTRY

the dti

CONSUMER AND CORPORATE
REGULATIONS DIVISION
SOUTH AFRICA



**REPORT
IN TERMS OF SECTION 10(1) OF THE
CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988(ACT 71 OF 1988)**

REPORT No. 127

Investigation in terms of section 8(1)(a) of the Consumer Affairs (Unfair business Practices) Act, 1988, in to the business practice of A1 Chic & Veg Franchise cc.

1. INTRODUCTION

The Consumer Affairs Committee ("Committee") resolved on 14 November 2008, to authorize a section 4(1) (c) (preliminary) investigation in terms of the Consumer Affairs (Unfair Business Practices) Act, No. 71 of 1988, (the Act), into the business practice of A1 Chic & Veg Franchise (Chic & Veg). This authorization was informed by a number of complaints received against the respondent by the Office of Consumer Protection (OCP). The purpose of the investigation was to gather more information on the business practice.

On 26 November 2009 the Committee further resolved to undertake a section 8(1) (a) investigation into the business practices of Chic & Veg. The Investigation Notice was published in *Government Gazette* No 33073 on 31 March 2010 under Notice No. 291 of 2010. Upon publication one comment was received. This was from a firm of attorneys representing a consumer who had not lodged a complaint with the Committee. The comment highlighted a pending case against Chic & Veg in the High Court of South Africa for a claim of one hundred and thirty five thousand rand (R135 000.00).

2. THE CONSUMER AFFAIRS COMMITTEE

The Committee was established in terms of section 2 of the Act. The purpose of the Act is to provide for the prohibition or control of unfair business practices and related matters. An "unfair business practice" is any business practice which directly or indirectly, has or is likely to have the effect of harming the relations between businesses and consumers, unreasonably prejudicing any consumer, deceiving any consumer or unfairly affecting any consumer or natural person.

The Act confers wide investigative powers on the Committee. In terms of the Act the Committee may conduct two types of formal investigations. First, in terms of section 8 of the Act, the Committee may on its own initiative, and shall on the directions of the Minister of Trade and Industry (the Minister), undertake such investigation as it may consider necessary into any unfair

business practice of particular individuals or persons that the Committee believes exists or may come into existence. Secondly, the Committee may investigate any business practice being applied by persons in general for the purposes of creating or maintaining an unfair business practice.

The first type of investigation is a section 8(1) (a) investigation in terms of the Act and the second a section 8(1) (b) investigation. These types of investigations are known as formal investigations.

The Committee can also undertake preliminary investigations in terms of section 4(1) (c) of the Act into the business practice of an entity. A section 4(1) (c) investigation enables the Committee to undertake such preliminary investigation as it may consider necessary into, or confer with any party in connection with, any unfair business practice which allegedly exists or may come into existence. Notice regarding a section 4(1) (c) investigation is not published in the *Government Gazette* as opposed to the notices in terms section 8 (1) investigations. The purpose of a section 4(1) (c) investigation is to enable the Committee to make a more informed decision as to whether a section 8(1) (a) investigation should be undertaken.

The Committee reports to the Minister on the result of any investigation undertaken by it in terms of section 8(1). If the Committee, after an investigation, believes that an unfair business practice exists, or may come into existence and is not satisfied that the business practice is justified in the public interest, the Committee in its report recommends to the Minister the action that should be taken to ensure the discontinuance of the unfair business practice. The orders of the Minister are published in the *Government Gazette* and a contravention of the Minister's order constitutes a criminal offence.

3. THE BUSINESS PRACTICES OF A1 CHIC & VEG FRANCHISE

A1 Chic & Veg Franchise (Chic & Veg) is a Close Corporation registered in terms of South African law with registration No.2001/022423/23. It is involved

in the business of selling franchises to consumers through advertisements in print media, including "SA Guide to Business Opportunity".

When consumers enquired about, and applied for, the advertised business opportunity, they were required to pay a non-refundable amount of five thousand rands (R5000.00) to Mr Sarel Grobler, the owner of the franchise business. This amount was said to be an administration fee relating to the approval of the consumer's application. Consumers were also required to pay the balance of the purchase price as stipulated on the franchise agreement upon signature of the agreement.

Chic & Veg, operated by Mr Grobler, who purported to be a franchisor, advertised that it was selling franchise business to potential franchisees. It is therefore important to understand the nature of a franchise agreement. A franchise agreement is essentially an agreement or a license between two parties which gives a person (franchisee) the right to market a product or service using the trademark of another person (franchisor). Franchisors are successful entrepreneurs (or are formed by successful entrepreneurs) who have developed particular business models. They allow franchisees to have access to their business know how by providing them with licenses to use their trademarks, intellectual property, operating and business plans and other proprietary information necessary for the operation of a franchised outlet. Franchisors also provide franchisees with the necessary training, support, advertising and marketing assistance that is necessary to promote their particular franchised brand. This enables the brands to penetrate the market and achieve greater brand recognition amongst consumers. In successful franchise relationships, franchisees have the right to operate carefully tested and proven systems and in return they will make regular royalty payments to their franchisors.

The interdependence between the parties is what makes franchising such an attractive proposition because each party wants the other to succeed. A prerequisite for successful franchising is that the franchisor must have in place the following: An existing good name, goodwill, a successful product or

service, marketing procedures, expertise, systems and support facilities. If a so-called franchise does not offer all of these pre-requisites, it is not a true franchise and consumers may be misled into paying for something which either does not exist or which does not have the means to support them as franchisees or meet their expectations.

4. THE INVESTIGATION

The purpose of the specific formal investigation undertaken by the Committee in terms of section 8(1) (a) of the Act was to obtain information regarding the business practices of Chic & Veg and/or Mr. Sarel Grobler and further to determine whether or not such practices are unfair to consumers. Where the practices are found to be unfair, the Committee has the power to make recommendations to the Minister regarding the control or prohibition of the business practices through the publication of a relevant notice in the *Government Gazette*.

The Committee received four complaints from consumers who allegedly responded to advertisements for a franchise business opportunity listed on "S.A Guide to Business Opportunity". These consumers applied for and paid substantial sums of money towards the franchise businesses. All in all, the four complainants paid R860 000 to Mr Grobler. Mr Grobler, allegedly failed to discharge his obligations in terms of the agreements or to remedy the breach and/or refund the complainants. In terms of complaints received by the Committee, the following issues were raised:

- One complainant was requested to sign a lease agreement with the landlord before the respondent could install shop fittings. This requirement was met by the complainant, who paid a deposit to the lessor.
- Another complainant was requested to apply for ADSL lines with Telkom for the operation of the franchise system. The lines were applied for and installed as requested.

The other allegations were that Mr Grobler:-

- Requested sizes of the corporate uniforms for members of staff. The sizes were provided but the uniforms were never delivered.
- Confirmed his awareness of his obligations in terms of the franchise agreement but advised the complainants that he had a family crisis.
- Verbally accepted that he had failed to perform in terms of the agreements and undertook to refund monies paid. He, however, failed to honour his undertakings.
- Proposed settlements agreed to make partial refunds, without admitting liability but failed to honour the settlement arrangement.

In one case Mr Grobler requested a letter of termination of the agreement from the complainant and, promised to revert to him, which he failed to honour. He was thereafter not contactable.

Another complainant secured a loan to finance the franchise business, and she remains indebted to the financial institution.

Complainants were at some point also advised to cancel the agreements but were informed that they would forfeit everything they had paid towards the establishment of the franchise business. Mr Grobler's undertaking to refund some of the money as goodwill failed to materialise.

For the purposes of this investigation, the following are some of the relevant obligations of the parties as set out in the franchise agreement:

FRANCHISOR'S OBLIGATIONS IN TERMS OF THE FRANCHISE AGREEMENT

In terms of clause 4 of the franchise agreement, the Franchisor shall, provided that all payments referred to in clause 10 and 11 thereof have been made:

- Disclose the business system to the franchisee and make available the

intellectual property rights licensed to the Franchisee in terms of this agreement,

- Arrange and facilitate, as agent, delivery to and purchase by the Franchisee of the items listed in annex "C" to the franchise agreement. Annex C refers to furniture, fittings, equipment and supplies to be installed at the premises.
- The Franchisor will advise and counsel the Franchisee in respect of the following matters relating to the establishment of the franchised business on the premises:
 - A floor plan of the proposed premises
 - "Suitable premises to be approved by the franchisee"
 - "Trade [ad] dress of the premises"

FRANCHISEE'S OBLIGATIONS IN TERMS OF THE FRANCHISE AGREEMENT

- Upon approval of the application, a non refundable deposit of R5 000.00 (excluding VAT) will be payable by the prospective franchisee. This deposit will be applied by the franchisor as an administration fee and will be in consideration for the grant to the franchisee of the non-exclusive right to use the franchisor's trade names, logo, products and service in terms of the agreement. The amount forms part of the purchase price.
- In consideration of the franchise rights granted, the franchisee shall pay a franchise fee in the amount of R45 000.00 (excluding VAT) on signature of the agreement, of which R40 000.00 is refundable subject to certain terms and conditions.

- The franchisee shall purchase and install the equipment, furnishings, signage and fittings listed in annexure "C" of the agreement. The franchisor shall act as the franchisees' agent in this regard and shall communicate with the relevant supplier and/or service *[provider]* on behalf of the franchisee in all respects relevant to such supply and installation.

(A copy of the Franchise agreement is attached herewith marked "A").

BREACH

The franchise agreement consists of certain breach clauses. The following clauses were relevant to the investigation:-

- In the event of the franchisee failing to pay the franchisor, by the due date, any sum due and owing to the franchisor hereunder or in any other way breaching the terms and conditions of this agreement, all of which are declared to be material, and failing so to pay or to remedy the breach within 7 (seven) days of written notice by or on behalf of the franchisor, calling upon the franchisee to make payment or remedy the breach complained of, or if the franchisee commits an act of insolvency or is sequestered or placed under a provisional or final winding-up or judicial management order, or fails to satisfy or take steps to have set aside any judgment taken against the franchisee, within 7 (seven) days after such judgment has come to the notice of the franchisee.
- The franchisor shall have all rights without prejudice to any other rights afforded to the franchisor in terms of this agreement or in law, to forthwith cancel this agreement by written notice to the franchisee and retain as a genuine pre-estimate of its liquidated damages all and any monies that it may have earned or received or have been paid as a deposit in terms of this agreement or as a result of any negotiations leading to this agreement.

On 26 November 2009 the Committee resolved to summons Mr Grobler to attend its next meeting. The summons was duly served on Mr Grobler's attorneys on 9 December 2009 as it was established that he was no longer operating at the physical address provided. Further, the landlord of the premises advised that he had terminated the lease agreement with Mr Grobler. Mr Grobler's attorneys undertook to inform their client of the summons issued by the Committee. Neither Mr Grobler nor his representative attended the meeting.

On 11 February 2010, the Committee resolved to proceed with the publication of a section 8(1) (a) investigation notice in the *Government Gazette* in view of the respondent's failure to co-operate with the Committee. A copy of the notice of investigation is attached hereto marked "B". A further complaint was received in March 2010.

On 30 July 2010, Mr. Grobler advised as follows:

- the business has been closed and is under liquidation;
- the complainants who have complaints against the Chic & Veg and or Mr Grobler should institute civil claims in order to recover their monies

The Master of the High Court- Western Cape was unable to confirm that he had received an application for liquidation by or against Chic & Veg and/or Mr Grobler.

5. COMMITTEE'S FINDINGS IN THE BUSINESS PRACTICE OF A1 CHIC & VEG

Chic & Veg and/ or Mr Grobler have continuously failed to fulfill its contractual obligations. More particularly Mr Grobler failed to provide any support for the establishment of the franchise business and instead failed to come to the assistance of any of the complainants. It appears to the Committee that Chic & Veg does not appear to be a properly established franchisor.

When consumers requested termination of their agreements due to non

performance, Mr. Grobler advised them that the payments which they had made would be forfeited to him. This, notwithstanding the fact that consumers were terminating the agreements because Mr. Grobler and/or Chic & Veg had failed to perform according to the standards required of a properly established franchisor. In the circumstances, Mr. Grobler was obtaining payments from consumers without carrying out any of the obligations of a franchisor.

The Committee has established that Chic & Veg is not a member of FASA (Franchise Association of Southern Africa); as such, complaints against the respondent could not be referred to and/or disposed of, in terms of the FASA code.

FASA is a self-regulatory institution which has, over time, developed a code of conduct which the Committee has acknowledged and refers to from time to time as a yardstick when considering business practices in the franchise industry.

In terms of the FASA Code:

- *Every Franchisor member shall ensure that all moneys which such Franchisor Member may receive from any other person ("the prospective Franchisee") in contemplation of the conclusion of a franchisee agreement are deposited in an attorney's trust account or a separate bank account maintained for that purpose.*
- *Where a Franchisor Member receives any moneys from any prospective Franchisee in contemplation of the conclusion of a franchise, as referred to above, and, whether at the instance of the Franchisor Member or the prospective Franchisee, negotiations in connection with such contemplated agreement are terminated without an agreement being concluded:*
- *The Franchisor Member shall refund the amount it has received*

forthwith, and not later than 30 (thirty) days after having received a written request from the prospective Franchisee,

- *The Franchisor may not retain any part of the amount it has received, save to cover reasonable out of pocket expenses that it has incurred in contemplation of the conclusion of a franchise agreement.*

The Franchisor member shall provide the prospective Franchisee with documentary proof of all such expenses. (Copy of FASA Code is attached marked "C")

The Committee has established that despite Mr Grobler having previously made offers to some complainants to make either full or partial refunds, he has failed to honour these settlement arrangements. The Committee has further established through media reports that there are other consumers who have entered into agreements with Mr Grobler. It has been reported that these consumers have also lost substantial sums of money.

None of the concluded franchise agreements dealt with by the Committee was fulfilled by Mr. Grobler and/or Chic & Veg and no refunds were made to consumers. Mr. Grobler has shown no willingness to co-operate with the Committee and its inspectors.

The Committee considered the following:

- The forfeiture clause in the franchise agreement, in terms of which consumers stand to forfeit all payments made should they cancel the agreement.
- Mr Grobler's failure to discharge his contractual obligations as a franchisor.
- Mr Grobler's refusal to refund complainants on cancellation of the agreement.
- Mr Grobler's failure and/or refusal to communicate with affected consumers.

The Committee is of the view that the business practice of Chic & Veg and or Mr Grobler, which business practice involves the sale of franchise businesses is prejudicial, deceptive, and unfairly affects consumers. It is further evident to the Committee that Mr Grobler and/or Chic & Veg is not an established franchisor, as this "franchisor" is receiving funds from consumers despite the fact that they do not appear to be in a position to fulfill their obligations as a franchisor and because consumers stand to forfeit the full franchise price paid even though it is Mr. Grobler who has failed to perform in terms of the agreement.

6. CONCLUSION /RECOMMENDATIONS

The Committee has concluded that the sale of franchises by Mr. Sarel Grobler and/or Chic & Veg constitutes an unfair business practice in terms of section 1 of the Act. The Committee is not satisfied that the unfair business practice is justified in the public interest.

The Committee is further of the view that it is not in the public interest to allow Mr. Sarel Grobler and/or Chic & Veg to continue disposing of any franchise business and or being entrusted with funds from consumers.

In order to prohibit the business practice, the Committee recommends that in terms of section 12 of the Act:

The Minister declares unfair and unlawful the business practices of Chic & Veg, and/or Mr. Sarel Grobler, and orders that both of the said parties refrain from the advertisement and or sale of any franchise business or any part thereof. Further that Mr. Sarel Grobler be prohibited from being entrusted with or from receiving funds from consumers.



PROFESSOR TANYA WOKER

CHAIRPERSON: CONSUMER AFFAIRS COMMITTEE