



# Call for legal clarification on franchises



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*There is concern that a court decision may mean the end of thousands of businesses*

JUST as big business is warning the Rudd Government to freeze spending for three years, a significant business association is calling for a government helping hand to clarify a legal decision with uncertain consequences.

The Franchise Council of Australia, which represents franchisors, that are often bigger small businesses, and franchisees, many of which are micro-businesses, is worried that a court decision might end up burning thousands of businesses.

And this is a \$150 billion industry with nearly 1000 franchise systems, contributing to 14 per cent of Australia's GDP.

FCA executive director Steve Wright is concerned about the wider implications of the decision of the NSW Court of Appeal in *Ketchell v Master Education Services Pty Ltd*.

"The FCA chose to get involved in this issue only after it had been through its third court process — NSW Court of Appeal — and because of its sector-wide implications, for both franchisors and franchisees," he says. "The FCA is not buying into the argument between Ketchell and Master Education Services, it is buying into the Court of Appeal decision, because of its potential ramifications for the whole sector — franchisors and franchisees."

The stoush between Jean Ketchell, the franchisee, and Master Education Services, the franchisor, was decided on by the NSW Court of Appeal.

It found that the relevant franchising contract was illegal because the franchisor had not obtained a signed certificate from the franchisee that said the Franchising Code of Conduct was fully understood.

The code says a franchisor must not enter into a franchise agreement unless the prospective buyer has signed a statement saying they had "received, read and had a reasonable opportunity to understand" a copy of the code.

In this case, the franchisor seemed to tick all of the code's disclosure boxes but did not obtain the written statement from the franchisee. It sounds like a technical mistake many franchisors could have made.

Wright sees this ruling as can of worms that could destabilise the franchise industry.

"The Court of Appeal ruling could be taken to mean that any agreement, no matter how successfully it has been operating for however many years, could be

deemed to be invalid if any technical non-compliance can be established by a litigant," he says.

"In the case in question, it was agreed that appropriate disclosure took place and the acknowledgement form was provided."

In an industry where history has shown that franchisors have had the whip hand in disputes, this ruling could work to the favour of franchisees who might be angry and want to get even.

"This interpretation appears to throw out the baby with the bathwater," Wright says. "It causes unnecessary uncertainty in existing agreements and could open up the sector to opportunistic legal action that may be more about commercial leverage in a functioning agreement than it is the total breakdown of an agreement."

OK, so why doesn't the FCA go full steam ahead and fight the case? It's a money thing.

"The High Court of Australia has granted special leave to the franchisor to appeal the decision," lawyer Stephen Giles of Deacons says.

"However, the court has essentially put the acid on the sector to fund the appeal as a condition of allowing the appeal to take place."

Giles estimates that with perhaps 50,000 franchise agreements in existence, 10 per cent could be affected. "This impacts not only the ability of franchisors to effectively enforce their agreements, but the ability of franchisees to sell their businesses confident they have a valid franchise agreement in place," he says.

Before the appeal in *Ketchell's* case can proceed, the franchisor must agree to pay the franchisee's costs of the appeal irrespective of the outcome. It is understood that the franchisor is somewhat reluctant to agree to do so, and has approached the Franchise Council of Australia to assist with funding.

"The FCA is a not-for-profit organisation with limited financial resources," Giles says. "It has in turn approached the Office of Small Business and the Australian Competition and Consumer Commission for assistance, offering to also approach its members to contribute to the costs of funding the appeal."

The High Court has given a strong indication of its willingness to clarify the law and Giles thinks the Government should dig deep for this important case.

Jason Gehrke, director of the Brisbane-based Franchise Advisory Centre, thinks that, whatever the outcome, franchisors will be forced to obtain the appropriate certificate from their franchisees and will contribute to best practice. But there could be wider problems of the decision.

"If the original finding is upheld by the High Court, then those businesses offering 'licences' or 'distributorships' will have cause to worry," he warns.



**Australian**  
**Tuesday 26/2/2008**  
**Page: 28**  
**Section: Business News**  
**Region: National Circulation: 133,000**  
**Type: National**  
**Size: 278.66 sq.cms.**  
**Published: MTWTF**

**Brief: BR&NEW**  
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“Most don’t consider themselves franchises and therefore do not provide disclosure or meet the other requirements of the code.”

*The Australian* contacted the Small Business Minister’s office on the matter but there was no reply.

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