Franchising Case Update 2013

Introduction

1 This paper focuses on just two franchising decisions that were handed down since the last FCA National Conference in 2012.

2 It reviews the decision in *St Leger Investments Pty Ltd v True Blue James Pty Ltd & Anor*[1] of the Federal Circuit Court of Australia in Melbourne delivered on 24 June 2013 which dealt with allegations of failure to comply with the *Franchising Code of Conduct* disclosure obligations and allegations of misleading or deceptive conduct.

3 The paper will then discuss the decision of the Supreme Court of Victoria delivered on 21 June 2013 in *Henderson & Ors v Purairclean Pty Ltd & Anor*[2]. This case deals with allegations of misleading or deceptive conduct, failure to comply with the *Franchising Code of Conduct* and breaches of contract.

***St Leger Investments Pty Ltd v True Blue James Pty Ltd & Anor* [2013] FCCA 601**

Introduction

4 *St Leger Investments Pty Ltd v True Blue James Pty Ltd & Anor* is a decision of Judge O'Dwyer of the Federal Circuit Court of Australia at Melbourne and was delivered relatively recently on 24 June 2013.

5 It is of particular interest in this year's case update because it involves the same franchisor as that identified earlier in today's seminar, namely *Dorrian & Anor v Rushlyn Pty Ltd & Anor*.

6 In this case St Leger Investments Pty Ltd (**Franchisee**) and True Blue James Pty Ltd and Rushlyn Pty Ltd (**Franchisor**) whereby the Franchisee alleged that the Franchisor failed to comply with the legislative provisions for disclosure and also made misleading or deceptive representations to induce the Franchisee, which it relied on, to enter into a franchise agreement. The Franchisee claimed damages in the sum of $268,764.35.

7 The Franchisor denied liability and counterclaimed to the amount of $16,500.

The facts

8 This case related to an agreement in mid-2010 whereby the Franchisee could sell subfranchises to 'service franchisees' (namely for house cleaning, car cleaning, window/external house cleaning, lawn/garden maintenance, pet grooming and carpet cleaning) in the Ballarat region.

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[1] [2013] FCCA 601
[2] [2013] NTSC 29

9 The principal complaint by the Franchisee was that the following representations had been made by the Franchisor to induce the Franchisee to enter into the franchise agreement:

(1) The Franchisor gave assurances to the Franchisee that the Franchisee's projected sales of 60 over 5 years was 'achievable' or 'easily achievable'.

(2) Representations were made to him as to why, for instance, the previous Ballarat regional franchisee failed, namely for ill-health and a failure by him to follow the system.

10 The second allegation is that the Franchisor did not disclose in its disclosure documents that:

(3) there was an earlier proprietor of the Ballarat regional franchisee whose agreement was terminated.

(4) there was also a Victorian statewide master franchisor which ceased to act in that capacity.

(5) the Franchisee had not been provided with the contact details of the previous regional franchisee and the Victorian statewide master franchisee. It was asserted that he would have made contact with them, as he did with the other franchisees whose names he had been given, as part of his due diligence exercise before entry into the agreement.

11 The Franchisee also alleged that:

(6) Its attempts to obtain the contact details of these parties were ignored by the Franchisor.

(7) It was also not disclosed to the Franchisee that the statewide master franchisor had informed the Franchisor that it could not meet its debts and continue trading.

12 The other relevant facts include that Mr Tyler was the director and controlling mind of the Franchisee and was in full-time employment with Racing Australia as an accountant when in June 2010 he resigned to pursue his interest in the franchise business.

13 It was of note to the Judge that the suggested pro forma business plan offered by the Franchisor was rejected by Mr Tyler as he believed it inadequate and he had a better one that he, as an accountant, would be happier using.

Held

Alleged representations made by Franchisor

14 In short, the Court found that the representations as pleaded by the Franchisee were not made. However, there are various aspects of the judgment worth identifying as set out below.

15 Judge O'Dwyer went to great lengths in an otherwise relatively short judgment to set out the 'behaviour' of the Franchisor. In fact, he deemed the behaviour of the Franchisor throughout the proceeding to deserve *'serious criticism*'.

16 It was found that Mr James, the director and controlling mind of the Franchisor, proved to be *'less than frank in complying with his obligations as litigant to the court. In giving evidence he impressed as a man in whom I would have little confidence in his veracity. He was defensive, prevaricated, evasive and generally unable to make small concessions.*' It appears that Judge O'Dwyer's findings were based on his evidence in Court and the fact that up until the third day of the hearing the Franchisor maintained vigorously that there was no franchise agreement between the Franchisee and the Franchisor and therefore the disclosure provisions of the Code were not enlivened. However, it then *'made a concession in that regard that should have been made early on in the proceedings'*.

17 The Franchisor also failed to disclose that a new Victorian State franchisor had been appointed, which was significant in regard to the Franchisor's cross-claim which was on foot at the time of the hearing, which was supported by affidavit material of Mr James and was a claim in excess of $500,000 that was then reduced to just $16,500.

18 The Court also found that the respondent's discovery was severely deficient, in particular the failure to discover a document that was contrary to the Franchisor's case.

19 It was found that the Franchisee's Mr Tyler impressed in the witness box as a *'very cautious man, perhaps pedantic, but he did not present as a dishonest man'*. However, Judge O'Dwyer had issues with the evidence of Mr Tyler. The court found that prudent practice would have dictated that the Franchisee not enter into the agreement until the contact details were provided and he had made contact with them as part of his 'due diligence exercise'.

20 Further, the court found that there was conflict in the evidence between the pleaded allegations of misrepresentation and both the affidavit of Mr Tyler and his evidence in the witness box. In particular, Counsel for the Franchisor described Mr Tyler's evidence on the alleged misrepresentation of Mr Tyler's projected sales of one franchise per month over 5 years was *'easily achievable*' as *'hopeless and shambolic'* and the Court restated this in its judgment.

21 The Court gave great weight to the fact that the originator of the notion of selling one franchise per month for 5 years was not the Franchisor's, but Mr Tyler's. The court also held that:

> *'He has not proved, in my view, that the projected sales were unachievable over time with the right approach and sales skills. In my view, in the exercise of his due diligence, he would need to have evaluated his own skills at sales and the suitability of his own personality in that regard. His complaint was made no sales in a very short period of only a few months and therefore repudiated the franchise. At the end of the day, I am not satisfied that some of the alleged representations were made because*

> *of the confusion as to places and times they were said to have been made. In any event, even if some of them had been made as alleged in respect of the achievability of sales, such representations, in my view, do not amount to a misleading or deceptive representation.*'

22 The court was also not satisfied that representations were made to the effect as alleged by the applicant, namely, that the explanation for the previous Ballarat regional franchisee's failure in the business was alcohol-related and was more likely to have been because he failed to follow 'the system'.

Reliance/causation

23 In short, the Court was not satisfied that even if Mr Tyler had made contact with the previous regional franchisee and master franchisee before entering into the agreement, he would not have committed himself to the franchise business.

The cross claim

24 As a result of the findings of the Court, the Court went on to find that the cross claim by the Franchisor was made out in which the amount due under the agreement which provided for minimum payments to be made until the Franchisor ceased conducting business in the shoes of the State master franchisee for Victoria in February 2012 and a new State franchisee was appointed.

Take out messages

25 It is clear that the Court was keen to confine the Franchisee's case to the pleading – which is the usual and right course to take. However, what it means is that the solicitors for a party who alleges misleading or deceptive conduct or makes other allegations really need to see all of its clients' evidence before pleading. Of course, if the client's record keeping is not great, there may be some documents that the defendant will provide during discovery that may force the party alleging the misleading or deceptive conduct to amend its pleading or reconsider the strength of aspects of its case.

26 This in itself can be troublesome. For instance, in light of some other decisions, such as in *Mirvac Queensland Pty Limited v Holland & Anor*[3], it is important that a solicitor should identify in the letter of demand, the representations as best they can even prior to commencing their court proceedings and they will need to be cognisant of any discrepancies in the evidence that its client has provided to them.

27 It is also of note that whilst the hearing dates were in April 2012 and the date of the last written submission was on 23 July 2012, the decision was not then handed down for another 11 months. 11 months is not an exceptionally long period of time to wait for a decision.

[3] [2010] QSC 330

However, in a misrepresentation cases where a Court must make some findings in relation to the conduct of the witnesses in the case, the longer the time between the provision of evidence and the decision can be of concern to litigants and clients should be aware of this. This is a relevant consideration for the Federal Court of Australia and the Federal Circuit Court of Australia (as in this case).

Postscript

28 The proceedings are currently before the court in relation to submissions concerning costs. The parties are currently awaiting judgment in this regard.

***Henderson & Ors v Purairclean Pty Ltd & Anor* [2013] NTSC 29**

Introduction

29 This is a decision of Chief Justice Riley delivered on 21 June 2013 after a five day hearing in May 2013.

30 It contained allegations of misleading or deceptive conduct, allegations of breaches of the Code, validity of the franchise agreement and restraint of trade.

The facts

31 In February 2009, the first plaintiff, Mr Henderson, worked as a Process Technician at a mine in Western Australia. As a result of a serious illness suffered by his wife he looked for other employment which did not require a fly-in/fly-out arrangement.

32 Mr Henderson saw an advertisement on the Seek website for a 'Jaymak Complete Coolroom Care Franchise' for the Northern Territory.

33 He entered into discussions with the National Business Manager of the second defendant and Mr and Mrs Henderson agreed to purchase the franchise and incorporated with the third plaintiff (**Hender**). They had received advice about the agreement and the business from an independent accountant but they indicated they did not obtain advice from an independent legal adviser and an independent business adviser.

34 They said they had made their own enquiries as to the likely profit and turnover of the franchise and its viability and they had not relied upon any representations from the franchisor.

35 On 4 May 2009 the plaintiffs entered into the Jaymak Franchise Agreement. On 28 May 2009 Mr Henderson was provided with the Jaymak Franchise Operations Manual (**May Manual**). On 1 June 2009 Mr Henderson was provided with the relevant user names and passwords to enable him to gain access to the manuals on the Jaymak intranet site.

36 On 15 June 2009 Mr Henderson informed the Managing Director of Jaymak that he had developed a system for cleaning split system air conditioners.

37 Interestingly, neither defendant claimed any interest in the cleaning process or the cleaning tray or pump to which Mr Henderson referred so there was no intellectual property dispute in this case.

38 The plaintiffs commenced operating the Jaymak franchise in June 2009.

39 On 30 August 2009 the franchisor produced a further manual (**August Manual**) which replaced the earlier reference to 'air-con vent cleaning and treatment' with 'air-con cleaning and treatment' as an authorised service for which a franchise fee was payable.

40 This was a new add-on service which the franchisor was offering. Mr Henderson was provided with a three month waiver on paying any franchise fees in relation to this new franchise add-on service in recognition of his contribution to writing service procedures and processes in relation to that work.

41 In January 2010 the Managing Director of the franchisor discussed with the Hendersons and other franchisees the prospect of separating the domestic air-conditioner cleaning business from Jaymak under a new franchise. The franchisor established Purairclean Pty Ltd for the purpose of establishing the new franchise business and Mr and Mrs Henderson joined the new franchise. Evidence of Mr Henderson identified that that side of the business *'grew at a considerable rate through 2009 and at September 2010 approximately two-thirds of the plaintiffs' revenue was coming from air-conditioning cleaning and sanitising.*'

42 On 20 October 2010 the plaintiffs entered into a franchise agreement with Purairclean. They did so after receiving the relevant disclosure document. The purchase price was a nominal amount of $1 in relation to which the Managing Director of the franchisor said *'I don't want you to pay any more than $1 for the air-conditioner franchise because you developed it.*'
Mr Henderson said in his evidence that the plaintiff company was not provided with any manuals, although he contributed substantially to the contents of the manual.

43 On 12 July 2011 the Hendersons and Purairclean signed a document described as an MOU in relation to the development of the Purairclean franchise agreement in which agreement was reached that Hender would receive $5,000 for every new franchisee recruited and trained in the system *'as well as a 30% profit share allocation'*. The relationship soured when the Hendersons asserted that the IP and knowhow in connection with the franchise business was developed by Mr Henderson and not Purairclean.

44 On or about 29 February 2012 the third plaintiff, Hender, ceased to trade as Purairclean NT. A new company, K&G Henderson Pty Ltd, was formed by the Hendersons. Mr and Mrs Henderson were the sole directors and shareholders of the new company.

45 K&G Henderson effectively took over the business that had previously been conducted by Hender under the names Purairclean NT and Jaymak NT. The new business serviced the same customers as had been previously served by Hender. For a period K&G Henderson traded under the name Purair Airconditioning but after a complaint from the franchisor the company rebranded. However, the phone numbers for the new business and the address from which the new business operated remained the same as for the Hender business throughout the whole period.

Jaymak representations

46 The plaintiffs relied on the wording in the Seek advertisement which stated *'With as little as 100 customers, you could have a business generating you over $150,000 in sales per year just in repeat business. This will be your goal for the first 18 to 24 months*'.

47 The plaintiffs alleged that the representations to Mr and Mrs Henderson through the Seek advertisement and subsequent conversations were to the effect that:

(a) the average turnover of a Jaymak franchise as at February/March 2009 was $150,000 per annum; and

(b) that average turnover was a conservative estimate;

(c) Hender and Mr and Mrs Henderson should exceed that turnover should they acquire a Jaymak franchise in the Northern Territory of Australia.

Held

48 After considering the evidence, the Court found that the representations made in the Seek advertisement did not make any reference to the average turnover of a Jaymak franchise as at February/March 2009 being $150,000 per annum. It found that what the advertisement does is advise a potential franchisee that:

(a) with as little as 100 customers;

(b) the franchisee could have a business generating over $150,000 in sales per annum;

(c) in repeat business.

It then says that this would be your goal for the first 18-24 months.

49 Insofar as the plaintiffs allege that Mr Christou (of the franchisor) represented that the franchisee 'should' produce a turnover that exceeds $150,000 per annum, the conversation must be considered in the context of the Seek advertisement which expressed the figure as a 'goal'.

50 The court found that the representations were as to existing facts or as to future matters. However, it held that there were reasonable grounds for making of those representations based on the figures prepared by the Managing Director of the franchisor in 2012.

The turnover figures of Jaymak NT

51 The court noted that it was apparent that the Henders preferred the air conditioning side of the business and put in increasing amounts of their time and effort into establishing that aspect of the business to the detriment of their coolroom cleaning side of the business. However, this does not suggest a lack of work and in any event the turnover of Jaymak NT in the relevant years did exceed $150,000.

Reliance

52 The court found that at the time of making the decision for Mr Henderson to leave his employment he had full awareness of the diagnosis of the illness suffered by his wife and was anxious to leave his fly-in/fly-out employment.

53 The court found that Mr Henderson would be a person who would be 'quick to protest if he thought he had been misled'. Further, the court noted that at the time of entering into the franchise agreement the Hendersons also signed a guarantee document and a document which appears to be a no representations deed.

Loss or likelihood of loss

54 The court found that the franchisee did not establish a causal link between the alleged conduct and the loss that is claimed. Further, it also found that the plaintiffs had not established that any loss was in fact suffered.

Contravention of the Franchising Code of Conduct?

55 The complaint of the plaintiffs was that in relation to each of the franchise agreements the disclosure requirements were not met because a copy of the franchise agreement 'in the form in which it is to be executed' was not provided to them at least 14 days before entering into the agreement.

56 In this respect, the plaintiffs were asserting that they had not been provided with the operations manuals until some time after the franchise agreement was executed.

57 The court found that even if the franchise agreement was not provided in the form in which it is to be executed it did not matter because the plaintiff was unable to identify any loss or damage or potential loss or damage from any breach of the Code. Further, neither the May Manual nor the August Manual either renewed or extended the agreement so the manuals were of no consequence.

Contract construction – uncertainty and incompleteness

58 In relation to the allegation of uncertainty of contract, the plaintiffs alleged that the franchise agreements were each executed in the absence of any manuals and 'as the manuals contained relevant information', there was 'no formal meeting of the minds'.

59 The Court noted that courts will endeavour to uphold contracts notwithstanding uncertainty of expression. Further, terms may be incorporated into a contract by reference. The court held that neither franchise agreement was uncertain or incomplete in a way that would make the agreement void or unenforceable.

60 Therefore, the plaintiffs arguments failed in all respects.

The Franchisor (defendant's) claim

The breach of the Jaymak franchise agreement

61 In April 2012 the franchisee ceased making any payment of management fees and in May 2012 it ceased operating under the agreement. The agreement was then terminated. In this respect, as the franchisor commenced operating due to the franchisee's absence, the Court was not satisfied that any loss would be suffered by the franchisor and it made no allowance in that regard.

The breach of the Purairclean franchise agreement

62 The Franchisor alleged that the plaintiffs breached the Purairclean franchise agreement by abandoning it. While the Court accepted there was a breach of the franchise agreement by the plaintiffs, the court reduced the award of damages for both past and future loss as it found that the franchisor failed to mitigate its loss by failing adequately to pursue the sale of the Purairclean franchise or by seeking to operate the franchise itself as it did with the Jaymak franchise.

Claim on guarantee

63 The court found that the Hendersons were liable to guarantee the performance of the obligations of the franchisee under each of the franchise agreements and provide indemnity in relation to breaches under the agreement. Accordingly, the Hendersons were personally liable to pay the award of damages to the Franchisor.

Restraint of trade

64 The Franchisor alleged that the plaintiffs breached the restraint of trade clauses in the franchise agreements. In this respect, each of the franchise agreements included a non-competition provision in identical terms. The restraint period was expressed at a cascading clause of 3 years through to 3 months or *'any other period during which a person seeking to enforce clause 24 is entitled at law to the benefit of protection afforded by the franchisee's covenant contained in clause 24 after the expiry or termination of this agreement*'. The Court held that there was, at the time the franchise agreement was entered into, a basis for imposing a restraint of trade.

65 The Court found that there was an established business in the field of the cleaning of residential air-conditioners which had been operating under the name of Jaymak NT when Purairclean NT commenced operation and took the benefit of the existing customer and existing procedures.

66 Importantly, the Court also held that there was no suggestion that there was a breach of the Jaymak Australia restraint of trade clause. The Court noted that the real issue is the restraint of trade clause contained in the Purairclean franchise agreement because:

(a) the plaintiffs commenced a new business on the day following the abandonment of the franchise;

(b) trading proceeded on the basis that customers of the former business would not recognise any change in business;

(c) the telephone numbers remained the same;

(d) the business was being promoted as being a continuation of the business that had been conducted for the previous three years under the franchise agreement.

67 Whilst the franchisor sought a period of restraint of two years from the date of termination of the franchise agreement, the Court held that a lesser period of one year from the termination date was more appropriate and would have been sufficient to protect the interests of the franchisor in all the circumstances. Accordingly, the Court held that the plaintiffs had breached the restraint clause and Mr and Mrs Henderson are liable for the loss under the terms of the guarantee and indemnity.

Take out messages

68 In relation to the alleged misleading or deceptive representations, the Court was keen to narrow its focus on the Seek advertisement. Whilst a copy of the Seek advertisement could not be located, the parties had agreed to the wording used in that advertisement, so the Court

could focus its attention on it. The Court then considered the alleged representations that arose from the oral conversations but only in light of the wording in the Seek advertisement. Therefore, if any representations are contained in documentation, they should be considered closely by the parties in relation to the representation cases as a whole.

69 It is important to note that the Court was not prepared to hold had that the Manuals should have been provided to the franchisee at the time that the Disclosure Document was issues or the Franchise Agreement was executed and therefore the Franchising Code of Conduct was not breached. This can give practitioners to their clients in relation to this issue in the future.

Postscript

70 The proceedings are currently before the court in relation to submissions concerning the issue of the damages awards and costs. The parties are currently awaiting judgment in this regard.