FRANCHISING CASE UPDATE 2013

Introduction

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

2. It reviews the following decisions:

   2.1 Dorrian and Anor v Rushlyn Pty Ltd and Anor [2013] FNCA 10; and

   2.2 SPAR Licensing Pty Ltd and Anor v MIS QLD Pty Ltd and Ors [2012] FCA 1116.

Dorrian and Anor v Rushlyn Pty Ltd and Anor [2013] FMCA 101

Introduction

3. This case is a decision of Judge Cameron FM of the Federal Magistrates Court, Sydney and was delivered on 21 February 2013.

4. It is of particular interest in this year's case update because it involves the same franchisor as that to be identified by my fellow presenter in the case of *St Leger Investments Pty Ltd v True Blue James Pty Ltd*.

5. In this case Mr Colin Dorrian and his wife Sharron Dorrian (**Franchisees**) and Rushlyn Pty Ltd (**Franchisor**) were parties to a Franchise Agreement. The Franchisees held a South Australian State Master Franchise for the franchise being the James Homes Services Franchise System. The Franchisees in this case alleged that the Franchisor had engaged in misleading and deceptive conduct in certain representations made by the Franchisor and the Franchisor director Mr James (also a respondent) and had breached the Franchise Agreement in its failure to provide a certain level of training and breaches of disclosure document in that it had failed to disclose the number of franchisees who had ceased to operate in the previous three years. The Franchisees claimed damages, as well as declarations that there were contraventions of the relevant legislation regarding misleading and deceptive conduct that the Franchise Agreement be declared void that the respondents repay all monies paid to them under the Franchise Agreement and an order for rescission of the Franchise Agreement.

6. The Franchisor denied liability and cross claimed an amount of $150,000 being the balance of the purchase price for the franchise.

The Facts

7. Rushlyn was a Franchisor in the cleaning and home maintenance industry under the name of James' Homes Services.

8. The Franchisees entered into a Master Franchise Agreement for the State of South Australia whereby the Franchisees could then sell sub-franchises to franchisees throughout South Australia.

9. The Franchisee's complaints fall into four main categories:

9.1 that following representations made by the Franchisor the Franchisees were induced to enter into the Franchise Agreement and that the representations constituted misleading and deceptive conduct for the purposes of the relevant legislation;

9.2 that the Franchisor had breached the Franchise Agreement in that pursuant to the Franchise Agreement the Franchisor was required to provide them with a certain amount of training for a period of 11 months and the Franchisor did not provide the level of training promised;

9.3 that the Franchisor was required to disclose in its disclosure document the number of franchisees who had in the three previous years ceased to operate and not having done so was a breach of section 51AD of the *Trade Practices Act*;

9.4 that the Franchisor had failed to disclose that up to 15 regional master franchisees in New South Wales and Victoria had ceased to operate between September 2006 and November 2008. The Franchisees alleged that if they had been aware of this information they would have made further enquiries and would not have purchased the State Master Franchise unless the Franchisor had given them an adequate explanation.

Misleading and deceptive conduct claim

10. The misleading and deceptive conduct was said to involve the representations as follows:

10.1 **Website training representation** – this involved an allegation by the Franchisees that on or about 2 June 2009, Mr Dorrian had seen an advertisement for the South Australian Master Franchise on the LJ Hooker Business Broking website. The Franchisees alleged amongst other things that this particular advertisement stated that:

> *"No experience in home services is required as all systems and training are supplied."*

10.2 **Qantas Club Lounge representation** – this representation relates to an allegation by the Franchisees that approximately a week later (9 June 2009) Mr Bennett (Franchisor's National Training Manager) gave a presentation to Mr Dorrian in the Qantas Club Lounge at Adelaide Airport. Amongst the allegations were that during this representation Mr Bennett represented to Mr Dorrian that what distinguished JHS from other franchise systems was that it provided high levels of support and training (known as the first part of Qantas Club Lounge support and training representations).

10.3 **Further representations** – the Franchisees allege that on or about 19 June 2009 a further representation was made this time by Mr James himself in the Qantas Club Lounge in Adelaide where:

(a) Mr James indicated that South Australia would be able to support between 10 and 12 regional master franchisees each with the potential to create more than 100 service franchises (**Qantas Club Lounge representation**);

(b) Mr James indicated that a distinguishing feature of this franchise system as compared to others was that JHS would provide a high level of support and

training to its franchisees (second part of "**Qantas Club Lounge support and training representations**"); and

(c) Mr James allegedly provided them with a booklet entitled "James Home Services Master Franchise Opportunity – secure your future with a proven system for success" which represented that they would be taught administration on at least three occasions during the initial training period ("**JHS Booklet Administration teaching representation**");

10.4 **Sales training representation** – the Franchisees allege that in June 2009 they each completed an attitudinal profile request of Mr James and that even though these profiles showed that neither Mr or Mrs Dorrian had significant selling aptitudes or abilities that Mr James represented that the training provided would remedy any such weakness or concerns.

10.5 **Cash flow forecast representations** – the Franchisees allege that following their return from Queensland they prepared a business plan as required by the Franchisor. After some discussions and meetings on Skype Mr Dorrian put forward the Franchisees' business plan forecasts and alleged that Mr James represented that those drafts appeared to be realistic and that the Franchisees would have no difficulty achieving those targets. According to Mr Dorrian's evidence, on the same day as the last Skype meeting he emailed his final version of his business plan and cash flow forecasts to Mr James and Mr James responded via email the next day saying that the figures in the business plan "looked good" and that the master franchise for South Australia was offered the very next day, which the Franchisees accepted.

11. The Franchisees alleged that they were induced to purchase the State Master Franchise by each of those representations set out above. By letter dated 14 August 2009 they agreed to purchase the State Master Franchise for a total purchase price of $450,000 plus GST, with $300,000 to be paid in cash and $150,000 to be financed by the Franchisor. On 17 September 2009 they executed the Franchise Agreement and paid the initial $330,000.

12. In short, the Franchisees alleged that the Franchisor engaged in misleading and deceptive conduct within the meaning of section 52 of the Trade Practices Act because:

12.1 contrary to the Website Training representation, the Franchisor did not supply adequate systems and training;

12.2 contrary to the Qantas Club Lounge Support and Training representations the Franchisor did not provide high or even adequate levels of support training;

12.3 contrary to the Qantas Club Lounge representation by Mr James, South Australia was not able to support between 10 and 12 regional master franchises each with a potential of 100 service franchises;

12.4 contrary to the JHS Booklet Administration Teaching Representation the Franchisor did not teach administration on at least three occasions during the initial training period;

12.5 contrary to the Sales Training representation the Franchisor did not address or remedy the applicant's lack of selling aptitude and ability; and

12.6 contrary to the Cash Flow Forecast representations the applicants did not achieve the represented franchise sales.

13. The Franchisees alleged that Mr James had accessorial liability for the company's contravention of section 52 of the TPA.

Allegation of breaches of the Franchise Agreement

14. **Training**:

The Franchisees alleged that the Franchisor was required to provide them with certain training for a period of 11 months following their initial one month of training after entering into the Franchise Agreement as follows:

14.1 Mr James, the National Training Manager, a National Sales Consultant or other suitable employee or contractor to be in attendance at Mr Dorrian's office in SA for two weeks per month for months 2-6 of the first year; and

14.2 the services of those same people in attendance for one week a month Monday to Friday for months 7-12 of the first year.

15. In breach of this the Franchisees say that between October 2009 and July 2010 the Franchisor's representative spent a total of 16½ days in attendance at the Franchisees' SA office which was significantly less than the 70 days they should have been there and that between July and August 2010 the Franchisor's representative spent no time at the Franchisees' premises where they should have been in attendance for a total of 5 days.

16. The allegation by the Franchisees was that these breaches allowed them to terminate the Franchise Agreement.

Allegations regarding disclosure document

17. The Franchisees also alleged that clause 6.4 of the Franchising Code of Conduct required the Franchisor to disclose the number of franchisees who had ceased to operate in the last three years and that in the disclosure document dated 3 September 2009 the Franchisor had failed to disclose that approximately 15 regional master franchisees in New South Wales and Victoria had ceased to operate. The Franchisees said that if they had known about this they would have at least made further enquiries and would not have purchased the State Master Franchise unless they were given satisfactory further information or explanations by the Franchisor. Mr James was alleged to have accessorial liability again here.

Relief

18. The Franchisees sought the following relief:

18.1 declarations that:

(a) the Franchisor had contravened section 52 of the TPA and section 52 of the FTA (SA);

(b) the Franchisor had contravened section 51AD of the TPA;

(c) the Franchisor had committed fundamental breaches of the Franchise Agreement;

(d) Mr James was involved in these contraventions by the company;

18.2 an order that the Franchise Agreement be declared void ab initio;

18.3 an order that the Franchisor repay all monies received by it under the Franchise Agreement;

18.4 an order that the Franchisor pay damages including all consequential losses suffered by the Franchisee;

18.5 an order for rescission of the Franchise Agreement due to its fundamental breach by the Franchisor and a refund of all monies paid under that Agreement;

18.6 damages for breach of contract.

Respondents Cross Claim

19. The company alleged that Mr and Mrs Dorrian's initiation of the proceedings constituted a repudiation of the Franchise Agreement, which the Franchisor accepted and that therefore the balance of the purchase price was due and payable. It also sought orders that the Franchisees pay its costs on a solicitor and client basis pursuant to the terms of the Franchise Agreement and the Deed of Guarantee entered into by Mr and Mrs Dorrian.

HELD

Alleged representations made by Franchisor – Misleading and Deceptive Conduct

20. In short the Court found that the representations as pleaded by the Franchisees were not made out on the facts. I might add here that the Judge in this case spent a significant amount of time going through and setting out the evidence of all the parties. In fact, almost 40 pages of the 89 page judgment deal with summarising the evidence.

21. At the outset of his considerations His Honour noted the following:

> *"Whether conduct is misleading or deceptive is a matter of fact to be determined objectively by reference to a reasonable person in the circumstance of the applicants. To determine whether the respondents' conduct was misleading or deceptive, the relevant course of conduct must be considered as a whole. Further for a claim to be successful it is necessary that there be a causal connection between the contravening conduct and the loss and damage allegedly suffered. Applicants must show that the misleading or deceptive conduct induced them to alter their position and that they have sustained or are likely to sustain a prejudice or disadvantage as a consequence."*

22. As for the alleged representations:

22.1 the Franchisor admitted that the Website Training representation and the JHS Booklet Administration Teaching representation were made;

22.2 the Qantas Club Lounge Support and Training representations:

(a) the Judge found that the evidence supports a conclusion that the first part of the Qantas Club Lounge Support and Training representations was made as alleged;

(b) on the evidence, the Judge was not persuaded that the second part of the Qantas Club Lounge Support and Training representations were made;

22.3 Sales Training representation - not made out on the facts.

22.4 Cash Flow Forecast representations – not made out on the facts.

23. The next question posed by the Court was whether the alleged representations made out on the facts amounted to misleading and deceptive conduct:

23.1 Website Training representations – found to be merely introductory not misleading and deceptive;

23.2 JHS Booklet Administration Teaching representation, Qantas Club Lounge representation and Qantas Club Lounge support and training representations – not misleading and deceptive;

23.3 Cash Flow Forecast representations – even if they were made out (which they were not) the Court would not have concluded that a reasonable person would have been misled or deceived by them;

23.4 Sales Training representation – this alleged representation was not proved so the Court did not need to make a finding as to whether the representation was misleading or deceptive;

Breach of Section 51AD

24. The respondents' submissions in defence of this allegation were that the information identified by the Franchisees had not been included in the disclosure document because the corporate franchisor had not been a party to franchise agreements with the regional master franchisees identified by the Franchisees in the proceedings.

25. The Court held in favour of the applicant's argument in this regard that the Franchisor should have included in its disclosure document the information which the Franchisees identified was omitted and that by failing to do so the Franchisor was in breach of section 51AD of the TPA.

26. The Court did not however award damages for the breach.

Breach of contract for failure to provide training

27. The Franchisees said they were only provided with a third of the training that they should have received under the Franchise Agreement. The Court found on the evidence in this case that the training that was meant to be provided for the 11 months after the initial one month training period was clearly not provided and that therefore the Franchisor breached the agreement. Mr Dorrian's lack of improvement (which the Franchisor attempted to attribute to his failure to follow the "48 hour rule") was caused by "*the insufficiency of the training given to him and that therefore the Franchisor's breach in their failure to provide adequate training caused the loss and damage to the applicants in the form of fewer sales and less income that would have been the case if that training had been provided*".

28. As for the appropriate measure of damages, the Court noted that the Franchisees sought both reliance and expectation damages. The Court held that they couldn't be compensated for incurred expenses and also for lost profits (*Commonwealth v Amann Aviation*) and found that the evidence could only support an award of reliance damages in that the Franchisees relied

on the unfulfilled assumption that the Franchisor would provide sufficient training in accordance with the Franchise Agreement.

29. In determining what that measure of damages was the Court found that the Franchisees were entitled to damages for *"reasonable expenditure which was wasted by their reliance on Rushlyn's promises, less any income realised from that expenditure*". That allowable expenditure amounted to $586,672 (minus its income as State Master Franchisee of $40,880) bringing the applicant's damages to $545,792.

30. As for Mr James' liability the Court found that it was not necessary to consider any personal responsibility of Mr James because the misleading and deceptive representations were not made out nor was the basis for any relief to be ordered in respect of the deficient disclosure document.

The Cross Claims

31. As a result of the Court's findings, it went on to find that the cross claim by the Franchisor was not made out.

Lessons for lawyers

32. The Court here clearly confined the Franchisees' case to their pleadings, particularly regarding the alleged misleading and deceptive conduct. This case clearly turned on and was decided on its particular facts. It is clear that lawyers should ensure that the pleadings in cases of misleading and deceptive conduct cases must contain the entirety of the evidence and that lawyers should test that evidence when the pleadings are being drafted.

33. It is clear here, by the methodical way in which the Judge approached the judgment (particularly in regards to the misleading and deceptive conduct claim) that the Courts are taking a strict approach in these type of cases.

34. It is interesting to note that the hearing dates were in November 2011 yet the judgment was not delivered until 21 February 2013, which is some 15 months later. This is relevant to solicitors thinking that the Federal Magistrates Court of Australia (now called the Federal Circuit Court) is a quicker way to go. This case shows that sometimes it is not.

35. I understand from the costs argument in this case (which the chair of our session can talk to in more detail) that although the Franchisees were only successful in their breach of contract claim, the Court awarded costs in their favour. So don't assume that costs will not be awarded against your client, even if it is successful in defending the majority of the claims against it.

***SPAR Licensing Pty Ltd and Anor v MIS QLD Pty Ltd and Ors* [2012] FCA 1116**

Introduction

36. This is a decision of Justice Griffiths in the Federal Court, which was handed down on 15 October 2012.

37. Allegations were made by the Franchisor applicant of breaches of contract and competition law claims relating exclusionary provisions in contravention of the *Competition and Consumer Act* (**CCA**). Cross claims were made by the Franchisee regarding contraventions of the Franchising Code of Conduct and misleading and deceptive conduct by the franchisor and its directors.

The Facts

38. The Franchisor (**SPAR**) was a supplier of dry groceries and related services to various supermarkets throughout Queensland and Northern NSW. The Franchisee (**MIS**) owned and operated a supermarket on MacLeay Island in Moreton Bay, Queensland.

39. In December 2010 MIS entered into a Special Offer Agreement followed by a Franchise Agreement in February 2011 with SPAR (collectively **the Contracts**). Under the Contracts SPAR was to provide dry groceries and related services to the MIS store. In August 2011 MIS attempted to exit these Contracts on the basis that it had entered into an "Alliance Agreement" with Metcash Trading Ltd (**Metcash**) and IGA Distribution Pty Ltd (**IGA**) (together **Metcash/IGA**) one of SPAR's competitors.

40. SPAR obtained an interlocutory injunction stopping MIS from exiting the Franchise Agreement and from purchasing dry goods other than from SPAR.

41. SPAR then bought these substantive proceedings against MIS for breach of contract and breaches of section 45 of the CCA. The breach of contract claim contained an allegation that MIS had repudiated the contract by entering into an alliance agreement with Metcash/IGA. SPAR further alleged that the alliance agreement with Metcash/IGA contravened section 45 CCA because it contained an exclusionary provision or had the purpose or likely effect of substantially lessening competition.

42. MIS defended the claim and brought its own cross claim. In that cross claim MIS asserted that SPAR contravened clauses 6B and 10 of the Franchising Code of Conduct by failing to provide MIS with current and required financial information before MIS executed the Franchise Agreement. MIS also claimed that SPAR, through its officer Mr Gale (General Manager at the time) made representations that were misleading and deceptive in contravention of the Australian Consumer Law (**ACL**). Their allegations were that Mr Gale had represented to the directors of MIS that it could terminate the Franchise Agreement on condition that it pay termination and related fees as set out in that agreement.

43. So in summary the issues before the Court were:

    43.1 Did MIS breach the Franchise Agreement?

    43.2 Was the provision in the Alliance Agreement an exclusionary provision for the purposes of the CCA?

    43.3 Did that provision have the purpose or likely effect of substantially lessening competition for the purposes of section 45 of the CCA?

    43.4 Did SPAR breach the Franchising Code of Conduct by failing to create and give MIS a current disclosure document?

    43.5 Did Mr Gale on behalf of SPAR engage in misleading and deceptive conduct?

HELD

44. **Did MIS breach the Franchise Agreement**?

    44.1 Yes. In seeking to terminate the Franchise Agreement and convert to IGA MIS were in breach of the Franchise Agreement. The Court accepted SPAR's submission that the Franchise Agreement did not confer any right of termination on MIS and that no

implied right of termination should be read into the Franchise Agreement. The Court further held that whether or not SPAR ultimately succeeded in its contract claim depended upon the Court rejecting MIS's cross claim (i.e. that the deficiencies in the disclosure document were of such significance that the Court should set aside or vary the Franchise Agreement and Special Offer Agreement and that similar relief should also be granted on the basis of the applicant's misleading and deceptive conduct which induced MIS to enter into the initial contracts).

44.2 The Court left full consideration of this argument until after its consideration of that cross claim which I will deal with later in this paper.

45. Was the provision in the Alliance Agreement an exclusionary provision for the purposes of the CCA?

45.1 The Court found that there was no exclusionary provision in contravention of the CCA because MIS and Metcash/IGA were not competitors in the relevant market. The only relevant market pleaded by SPAR for the purpose of this exclusionary provision argument was said to be the MacLeay Island retail market. It was admitted by SPAR's Counsel that the evidence in support of that contention was limited and that it was a difficult case to make out as "there was no evidence before the Court which contradicted the proposition that Metcash/IGA are wholesalers, not retailers, and did not themselves operate any supermarket in Queensland at a retail level".

45.2 The Court held that SPAR failed to establish that MIS and Metcash were competitors in MacLeay Island retail market because:

(a) first the "evidence establishes that in cases where Metcash/IGA are involved in developing or establishing a retail supermarket site, they do not operate the site themselves as retailers";

(b) secondly the evidence did not establish "that IGA intended to operate a retail market on MacLeay Island in the sense of becoming a supplier in that market "as opposed to being a wholesale supplier to that market";

(c) further, there was no evidence to show that IGA had any plans to operate any retail supermarket on Macleay Island or otherwise. The Court found that SPAR's contentions that Metcash/IGA were suppliers in the Macleay Island retail market may have been based on *"an erroneous understanding of the concept of a "market" for the purposes of the CC Act"*. The Court found that the Macleay Island retail market is a market for *the "retail supply of dry grocery products and related services on Macleay Island*". The Court found that the contention by SPAR that the suppliers in that market are both MIS and IGA/Metcash could not be accepted on the basis that on the evidence presented in the case MIS was a retail supplier whereas Metcash/IGA were wholesale suppliers. The Court found that *"…SPAR has failed to establish that MIS and Metcash/IGA are competitors in the MacLeay Island retail market. The evidence overwhelmingly demonstrates that MIS is a supplier in that retail market, whereas Metcash/IGA are suppliers in one or other wholesale markets. Of course, as wholesalers, Metcash/IGA have a keen interest in ensuring that IGA bannered stores operate successfully in retail markets because such success is beneficial to their wholesale business. But such an interest falls well short of establishing that Metcash/IGA are themselves actual or potential suppliers in the MacLeay Island retail market"*. On this basis the competition law claim was rejected by the Court.

46. **Did that provision in the Alliance Agreement have the purpose or likely effect of substantially lessening competition for the purposes of section 45 of the CCA?**

46.1 The Court found that SPAR failed in this argument. The only relevant market before the Court was the Macleay Island wholesale market because SPAR had not provided sufficient evidence to support or establish the existence of any of the other markets that it had pleaded in its statement of claim.

46.2 In short the Court found that SPAR had failed to bring sufficient evidence to support its claims; that it could not satisfy the Court that if it was removed as a wholesale supplier from that market that it would substantially lessen the competition in that market:
"In my opinion the removal of SPAR as a wholesale supplier on MacLeay Island in circumstances where that supplier constitutes no more than 1% of SPAR's total sales of dry groceries on a wholesale basis in Queensland falls well short of satisfying the requirement that any prescribed purpose in the provision substantially lessens competition in the Queensland wholesale market".

46.3 The Court also found that it was unlikely that competition at a retail level would be substantially lessened simply because SPAR was removed as a wholesale supplier:

47. Did SPAR breach the Franchising Code of Conduct and therefore section 51AD of the TPA by failing to create and give MIS a current disclosure document?

47.1 This allegation is said to arise because the disclosure document that was provided in July 2010 was not a disclosure document within the meaning of the Code of Conduct because the document did not contain certain financial details and information.

47.2 What is important to note here is that although MIS received a disclosure document on 21 July 2010 the Franchise Agreement was not executed until 1 February 2011, some six months later.

47.3 MIS's concerns with the disclosure document were that it was not compliant in that it did not contain a director's statement of solvency for the relevant financial year. It only provided one as at 30 June 2009 not at 30 June 2010. There were no financial reports provided with that disclosure document. MIS further submitted that the disclosure document and draft franchise agreement that they relied upon in deciding on whether to become a SPAR franchisee did not contain certain information regarding the finances of the company and if they had known the true financial position of SPAR they would not have entered into the Special Offer Agreement or the Franchise Agreement.

47.4 The material that was not provided by SPAR which was ultimately in evidence at the trial showed that in that six month period between the provision of the disclosure document and the execution of the Franchise Agreement, SPAR's financial position had deteriorated significantly. For example, it had lost approximately $5.8 million for the financial year ended 30 June 2010; Westpac had restricted SPAR's credit by capping its finance facility; a qualification was made by the directors that there remained significant uncertainty that the group would continue as a going concern which was further declared by its auditors. This financial information was not contained in the disclosure document and was not provided in that six month period between the provision of the disclosure document and the signing of the Franchise Agreement.

47.5 SPAR argued that it had complied with its obligations to provide a current disclosure document to MIS in that at the time it was provided it was the most up to date version. Its argument appeared to be that it was sufficient for it to create a disclosure document within four months after the end of the financial year and to use that document until such time as another one was created within four months after the end of the next financial year.

47.6 The Court did not agree with this argument and it was found that

"…*in circumstances where the Franchise Agreement between SPAR Licensing and MIS was not executed until 1 February 2011, I consider that SPAR Licensing was obliged to create and provide MIS with a disclosure document which contained the required financial information pertaining to SPAR Licensing … which was current at the time MIS's directors were determining whether or not to sign the Franchise Agreement."*

47.7 In finding that SPAR had contravened the Code of Conduct, the next question was whether it was appropriate to grant the relief sought by MIS being damages for the loss suffered by reason of that conduct and an order pursuant to section 87 of the TPA that the Franchise Agreement and/or Special Offer Agreement were void.

47.8 The Court held here that it was an appropriate case for such declaration to be made but did not find any basis upon which MIS should receive an additional award of damages.

47.9 As to whether the Franchise Agreement should be varied or set aside the Court considered the High Court's judgment in the *Master Education Services* case and determined that this was an appropriate case to vary the terms of the Franchising Agreement but not to set it or the Special Offer Agreement aside. In its discussion here the Court found that although the contravention was a serious matter, it was more appropriate to vary the terms of those agreements such as to enable MIS to terminate on payment of the requisite termination and associated fees. This was because despite the seriousness of the contravention MIS's resultant financial losses were quite modest - approximately $21,000 during the time it was a SPAR franchisee.

48. Did Mr Gale on behalf of SPAR engaged in misleading and deceptive conduct?

48.1 MIS claimed in the second limb of its cross claim that before executing the Special Offer Agreement and Franchise Agreement SPAR (through Mr Gale) represented to it that if MIS became a SPAR franchisee and then later wanted to convert to an IGA it could terminate its Franchise Agreement on the condition that it pay SPAR the termination and related fees which were set out in the Franchise Agreement. MIS claimed that these representations were misleading and deceptive because SPAR were now seeking to restrain MIS from terminating the Franchise Agreement (and had obtained an interlocutory injunction to that effect).

48.2 The Court again here took a methodical approach to determine whether there was misleading and deceptive conduct. The questions it posed were as follows:

(a) Were the alleged representations made by or on behalf of SPAR?

(b) If so, were they misleading or deceptive?

(c) If questions 1 and 2 above are satisfied, were they relied upon by MIS in deciding whether to enter into the Special Offer Agreement and Franchise Agreement?

(d) Is there a causal link between the representations and any loss or damage suffered?

(e) If so, what relief should be granted if any?

48.3 The Court found:

(a) that MIS established that the alleged misrepresentations were made.

(b) that those representations were misleading and deceptive because contrary to the terms of the representations SPAR refused to permit MIS to exit the Franchise Agreement, sought and obtained an interlocutory injunction preventing them from doing so, brought proceedings seeking an order of specific performance of the agreement and sought an order restraining MIS acquiring goods from anyone else but SPAR;

(c) that Mr Aplin and Mr Sichter of MIS both relied on the representations made by Mr Gale of SPAR. Even though the third director of MIS did not give evidence, the Court found that those that did represented the majority of directors and held 75% of the shares in MIS and so the evidence provided a sufficient basis to find in favour of MIS under this limb.

(d) as to whether there was any loss and damage? Yes but it was limited to $21,172.

49. **Relief**

In terms of relief the Court made:

49.1 a declaratory order concerning the contravention of section 18 of the ACL by SPAR;

49.2 an order under section 87 of the CCA varying the Franchising Agreement and related Special Offer Agreement ab initio so as to reflect Mr Gale's representations;

49.3 an order that SPAR pay damages for the period 1 September 2011 to the date of judgment plus interest; and

49.4 an assessment of the quantum of termination and related fees payable to SPAR upon MIS terminating those agreements.

The Court gave the parties time to confer and seek to agree the terms of the orders reflecting his reasons.

Lessons for lawyers

50. The significance of this case is the quite expansive interpretation of a franchisor's obligations regarding disclosure pursuant to the Franchising Code of Conduct. Following the logic of this judgment:

50.1 it is not sufficient for a franchisor to provide a current disclosure document in circumstances where the financial situation of the franchisor changes significantly or some other aspects of the franchise system change significantly in a short period of time;

50.2 a franchisor is under a continuing disclosure obligation regarding prospective franchisees particularly where engaged in protracted negotiations;

50.3 franchisors should revisit their disclosure documents prior to execution of any franchise agreements to ensure that there have been no material changes that make the disclosure document in some way out of date or misleading.

50.4 a franchisor may not be able to just rely on a single disclosure document which is produced annually within four months of the end of the financial year.

51. This is also a lesson to franchisees that they should ensure that they undertake considered due diligence to determine whether the Franchise Agreement accurately reflects what the parties have agreed. So for example in this case if the early termination rights had been clearly set out in the Franchise Agreement and the directors of MIS had not just relied on the representations made, then the litigation and the costs thereof could have been avoided.

Postscript

52. SPAR has appealed this decision to the Full Federal Court. The appeal was to be heard in February 2013 with a judgment due sometime later this year. At the time of submitting this paper, no appeal judgment had yet been handed down.

Cristina Cecere, Piper Alderman

September 2013