



Franchising Alert January 2008

Important Recent Franchising Decision

“ Failure to comply with the Franchising Code of Conduct may have the consequence that a franchise agreement is void and unenforceable. ”

The recent decision in *Ketchell v Master of Education Services Pty Ltd* (“Ketchell Decision”) illustrates that failure to comply with the Franchising Code of Conduct (“Code”) may have the consequence that a franchise agreement is void and unenforceable.

Background

The Ketchell Decision involved legal action by a franchisor to recover money due from a franchisee under a franchise agreement. The franchisee in defence argued that the franchise agreement was illegal and unenforceable because it was entered into without the franchisor having obtained from the franchisee a written statement as required by the Code. The relevant section of the Code is 11(1), which stated at the time:

“The franchisor must not:

- > enter into, renew or extend a franchise agreement; or
- > enter into an agreement to enter into, renew or extend a franchise agreement; or
- > receive a non-refundable payment under a franchise agreement or an agreement to enter into a franchise agreement;

unless the franchisor has received from the franchisee or prospective franchisee a written statement that the franchisee or prospective franchisee has received, read

and had a reasonable opportunity to understand the disclosure document and this code.”

The Code is a mandatory industry code prescribed under section 51AE of the Trade Practices Act (“TPA”). Section 51AD of the TPA prohibits a corporation contravening an applicable industry code.

Decision

In short, the New South Wales Court of Appeal (“Court”) held that the effect of section 11(1) of the Code, in stating that a franchisor “must not” enter into a franchise agreement without obtaining the required statements, was to render a franchise agreement entered into without complying with that requirement illegal and unenforceable. Since it was established in this case that these written statements were not obtained by the franchisor, the franchise agreement was held unenforceable.

The Ketchell Decision indicates that failure to obtain a statement as required by section 11(1) of the Code will result in a franchise agreement being invalid and unenforceable. While the Ketchell Decision focused on section 11(1) of the Code, there is the possibility that other breaches of the Code may also result in a franchise agreement being unenforceable. In addition, while the Ketchell Decision involved a defence raised by the franchisee, there is also the possibility that a franchisee might raise the principle in the Ketchell



Decision as a positive cause of action to have a franchise agreement declared unenforceable at some stage during the term of the franchise agreement (ie, after that agreement has been in force for some time). A franchisee who is successful in such a case may have an entitlement to be paid damages by the franchisor if the franchisee can establish that the failure by the franchisor to comply with the Code caused the franchisee loss or damage. It seems unlikely that the courts will depart from the Ketchell Decision as it was a unanimous decision of the Court and is consistent with High Court authority.

Consequences and Recommendations

We consider that:

- > failure to comply with clause 11(1) of the Code will render a franchise agreement illegal and unenforceable;

- > if clause 11(1) of the Code has not been complied with, there is a risk that a franchisee may challenge the franchise agreement at some time and be released from its obligations and possibly entitled to be paid damages by the franchisor; and
- > breaches of other requirements of the Code may have the same effect (depending upon the terms of the relevant provisions of the Code).

We recommend that franchisors:

- > incorporate the signed statements required by section 11(1) of the Code into their standard franchise agreements; and
- > ensure that franchisees execute franchise agreements prior to them being executed by the franchisor.

That way, by signing the franchise agreement itself the franchisee is providing the signed statements required by the Code, before the franchise agreement is entered into. Franchisors may also wish to obtain separate written statements and retain them on file (although in our view this would not be required if the recommendations above have been implemented).

Franchisors may also wish to audit their paperwork to ensure that there has been compliance with section 11(1) of the Code. Franchisors should also be concerned to ensure that their other obligations under the Code are complied with, including the obligation to provide a disclosure document at least 14 days before entering into a franchise agreement (or agreement to enter into a franchise agreement) or receiving a non-refundable payment.

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