



## Franchising Alert September 2008

### Ketchell - what does it mean?

“Failure to comply with the Franchising Code of Conduct will not automatically invalidate a franchise agreement”

The High Court recently gave its judgment on the most important franchise case since the introduction of the Franchising Code of Conduct. As pre-empted by Thomson Playford Cutlers' Partner, Sean O'Donnell, the High Court allowed the franchisor's appeal against a decision of the NSW Court of Appeal. The NSW Court of Appeal had declared a franchise agreement to be void and unenforceable as a result of the franchisor's non-compliance with clause 11 of the Code.

The judgment vindicates the Franchise Council of Australia's decision to fund the costs of the High Court appeal. However, the decision is not a panacea for franchisors who fail to comply with the Code. In a unanimous judgment, the High Court found that although a technical breach of the Code does not automatically make a franchise agreement void, it does allow a franchisee to seek remedies available under the Trade Practices Act.

Click here to read the full decision delivered by the High Court:

<http://www.austlii.edu.au/au/cases/cth/HCA/2008/38.html>

#### Facts

Initially, the franchisor in this case commenced legal proceedings in the NSW Local Court against its franchisee who had not paid fees due under the franchise agreement. In her response, the franchisee argued that the franchisor had not complied with clause 11(1) of the Code, which deems it unlawful for the franchisor to receive any money pursuant

to the franchise agreement unless the franchisor is able to produce the written statement required by clause 11(1).

Clause 11(1) of the Code currently provides that:

*'the franchisor must not:*

- (a) enter into, renew or extend a franchise agreement; or*
- (b) enter into an agreement to enter into, renew or extend a franchise agreement; or*
- (c) receive a non-refundable payment (whether of money or of other valuable consideration) 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 NSW Court of Appeal agreed with the franchisee and held that, by failing to comply with clause 11(1) of the Code, the franchisor had contravened section 51AD of the Trade Practices Act 1974 (**TPA**). As a result, the Court of Appeal held that the franchise agreement was illegal and void. This meant that the franchisee was not required to pay the fees claimed by the franchisor.

The franchisor appealed this decision to the High Court.



## Decision

Acting Chief Justice Gummow ACJ and Justices Kirby, Hayne, Crennan and Keifel unanimously disagreed with the decision made by the NSW Court of Appeal.

In a compelling decision, their Honours found that although the franchisor may have breached the Code and, as a result, s 51AD of the TPA, this was not of itself sufficient to prohibit the making of a franchise agreement. When issues of non-compliance with the Code arose, their Honours stated that the proper approach was to consider the circumstances surrounding the parties' entering into the franchise agreement to determine what, if any, relief should be granted. The Court adopted the comments made by Justice Rares in *Hoy Mobile Pty Limited v Allphones Retail Pty Limited (No 2)* where it was said:

*'It would be an unusual result if, in that circumstance, a franchisee's bargain was struck down in every case regardless of the position in which it places the franchisee. It is not to be assumed in every case that a franchisee wishes to be relieved of their bargain. To render void every franchise agreement entered into where a franchisor had not complied with the Code would be to give the franchisor, the wrong-doer, an opportunity to avoid its obligations, and at the same time to place the franchisee in breach of obligations to third parties.'*

This was an important finding because in this case it was not contested that the franchisor had actually given the franchisee a copy of the disclosure document and Code. The breach arose only because the franchisor was unable to produce the written statement that is required by clause 11(1).

## Not a panacea for failure to comply with disclosure obligations

Franchisors must realise that this decision does not mean that franchisors who breach the disclosure provisions are able to avoid liability. Some commentators have suggested that the High Court's findings mean the end of uncertainty for franchisors and franchisees who have signed franchise agreements which do not comply with the Code. This is oversimplifying the decision.

Franchise agreements entered into in breach of the Code will be in contravention of s 51AD of the TPA, and franchisees will be able to seek relief under the TPA. The available remedies are far-reaching and can have some very detrimental consequences. For example, a franchisee who can establish that a franchisor did not provide proper disclosure may be able to recover damages (including initial franchise fees or fees otherwise payable under the franchise agreement) or an order

which will operate to vary the franchise agreement. The Court can even declare all or part of the franchise agreement void. On this issue the Court said:

*'In some cases the non-compliance may be such as to warrant the court striking a contract down on the application of a franchisee.'*

## Consequences of this decision

This decision illustrates that a franchisor's failure to provide proper disclosure will be a breach of the TPA. This may entitle the franchisee to a remedy, including injunctive relief and damages. In cases of serious non-compliance with the Code, the franchise agreement may be varied or set aside.

Franchisors must take their obligations to comply with the Code seriously and must take proactive steps to minimise the risk of breaching the Code. This will involve making sure that compliance procedures are in place to ensure that proper disclosure is made and the written statements and acknowledgements required by clause 11 of the Code are obtained, and can be produced, if required.

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