

Consequence for Breach

The Law

A failure to comply with the Franchising Code (**Code**) is a breach of section 51AD of the *Trade Practices Act 1974* (Cth) (TPA).

Section 51AD of the TPA prohibits corporations from contravening a mandatory industry code. A mandatory code is defined under the TPA as meaning an industry code that is declared by regulations under section 51AE to be mandatory. The Code was declared by regulations under section 51AE of the TPA to be mandatory on 1 July 1998.

The Code places obligations on parties to a "franchise agreement". Specifically, franchisors are required to disclose specific facts and follow set procedures in their dealings with franchisees.

The Australian Competition and Consumer Commission (**ACCC**) or a complainant may institute legal proceedings against the franchisor and the directors of the franchisor alleging a breach of the Code has occurred or that the complainant suffered, or is likely to suffer, loss or damage as a result of the franchisor's or the franchisor's directors breach. Further, a failure to comply with the Code is a ground of unconscionable conduct under section 51AC of the TPA.

There are a range of remedies available to the affected party where a court finds that a breach of the Act has occurred. Ultimately it is the court's decision as to the appropriate remedies.

Where there is a breach of the Code, remedies that may be available to the Court include:

1. an order for compensation for loss or damage caused by actions of another in breach of the Code under section 82;
2. an injunction under section 80;
 - 2.1. requiring a person to do an act or thing;
 - 2.2. restraining a person from engaging in specified conduct: section 80(4);
3. any other orders against the person who engaged in the conduct or any person who was involved in the contravention as it thinks appropriate under section 87 such as the following orders:
 - 3.1. declaring the whole or part of the contract void;
 - 3.2. varying contracts or arrangements;
 - 3.3. refusing to enforce a contract;
 - 3.4. directing the person who engaged in the contravening conduct to refund money or return property;
 - 3.5. for the payment of compensation;
 - 3.6. to undertake repairs or supply parts;

- 3.7. to undertake community service;
- 3.8. to provide corrective advertising;
- 3.9. to provide specified services; and
- 3.10 to terminate a lease and mortgage or require land to be transferred.

The ACCC has determined that pecuniary penalties (fines) are not available as a remedy for contravention of the Code. Pecuniary penalties are, however, available as a remedy for contravention of provisions of the TPA in relation to conduct such as third line forcing, price fixing and resale price maintenance.

While there is no criminal sanctions for a breach of section 51AD are prescribed under the TPA, non-compliance with the Code may constitute a breach of various directors duties as prescribed by equity, common law and statute (in particular the *Corporations Act 2001* (Cth)). In addition, a breach of the Code and the Act, may also result in a number of commercial consequences such as poor publicity which is likely to have a detrimental effect on business.

NOTE: Proceedings for breach of section 51AD of the TPA must be brought within six years of the date on which the applicant has suffered, or is likely to suffer, loss or damage.

Example 1

Franchise: Master of Education Services Pty Ltd
Conduct: Breaches of the Code
Outcome: High Court overturned orders of the NSW Court of Appeals (August 2008)

Ketchell, a franchisee in the Master of Education Services franchise, owed \$26,000 in franchise fees to the franchisor. Ketchell claimed the \$26,000 was not payable as her franchise agreement was invalid following the Franchisor failed to comply with the renewal requirements of clause 11(1) of the Code. The NSW Court of Appeals supported Ketchell and declared the franchise agreement illegal and invalid. The case was then given special leave to appear in the High Court.

The High Court held that this failure to comply with the Code did not result in the illegality and unenforceability of the franchise agreement. The High Court found the franchisee to be adequately protected by the remedies available under the Trade Practices Act and did not require that the agreement be void.

The High Court warned non-compliance may warrant the court striking a contract down on the application of a franchisee and only 'inconsequential' breaches would avoid serious consequences.

Example 2

Franchise: JV Mobile
Conduct: Breaches of the Code
Outcome: Court enforceable undertakings (April 2007)

JV Mobile promoted and advertised its business network as a franchise, and sought (and/or received) payments to operate as a franchised retail business. Despite operating and marketing itself as a franchise, JV Mobile failed to provide its retailers (franchisees) with all of the

safeguards available under the Franchising Code of Conduct, including the upfront provision of a disclosure document.

The company provided court enforceable undertakings to prevent the conduct from recurring.

Example 3

Franchise: ContactPlus Group Ltd
Conduct: Breaches of the Code, misleading and/or deceptive conduct
Outcome: Federal Court declarations and orders (February 2006)

ContactPlus sold licences to use its software and marketing database to run recruitment/employment businesses. The ACCC believed this license system to be a franchise business and, as such, ContactPlus breached the Code by failing to provide the franchisees with the required documentation and rights prescribed under the Code. It was also alleged that ContactPlus and its director made false, misleading and/or deceptive claims, including their right to payment of a lump sum licensee fee.

The court declared that the ContactPlus was a franchise system and found its claims were misleading. The court imposed injunctions.

Example 4

Franchise: Scotty's Premium Pet Foods Pty Ltd
Conduct: Breaches of the Code, unconscionable conduct
Outcome: Court enforceable undertakings (November 2006)

Scotty's Premium Pet Foods issued some of its franchisees with notices claiming they had breached their franchise agreements. These notices required that they remedy the alleged breaches within 14 days or the franchise would be terminated. The ACCC considered that this timeframe was unreasonable and that the notices did not sufficiently describe the alleged breaches or the remedy required.

Scotty's also attempted to directly supply products to a business customer of one of their franchisees within their 'exclusive' territory.

The company provided court enforceable undertakings to prevent the conduct from recurring.

Example 5

Franchise: You Can Bake-It Franchising Pty Ltd
Conduct: Breaches of the Code
Outcome: Court enforceable undertakings (January 2005)

Concerns were raised by a number of existing franchisees regarding the disclosure document provided by You Can Bake-It Franchising. The ACCC was concerned that sections of the provided disclosure document were ambiguous and misleading.

The company cooperated with the ACCC, providing undertakings that it would remedy the issues so they did not recur in the future.

Example 6

Franchise: 4WD Systems Pty Ltd
Conduct: Breaches of the Code
Outcome: Federal Court declarations (2003)

4WD Systems Pty Ltd distributed parts for four wheel drive vehicles. The ACCC believed this franchise system was in breach of the Code failing to provide the requisite disclosure statement.

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