

REPRESENTATIONS IN FRANCHISING

Franchisors need to ensure that they are careful regarding representations they make about a franchise to a potential franchisee. Franchisees must also exercise caution about the information that they are relying on before they enter into a franchise. There can be serious consequences for both franchisors and franchisees for not double checking facts.

When a franchisor makes a representation to a franchisee about the potential or viability of a franchised business, they must ensure that the information they are relying on is accurate. Franchisors may be found guilty of misleading and deceptive conduct under the *Competition and Consumer Act 2010* and be liable to a franchisee for damages.

Franchisors need to make sure that:

- If they are going to make a representation to a franchisee, that they have evidence and records to back up the basis for a representation.
- Their representations are included in the Disclosure Document provided to franchisees before a franchise agreement is signed. For more information on Disclosure Documents, read our article [The Disclosure Requirement in Franchising](#).
- They avoid stating personal opinions.
- Their staff are trained to know what they can and cannot say to potential franchisees.

The new Franchising Code of Conduct which took effect on 1 January 2015 has introduced new record keeping requirements which franchisors must adhere to. If a franchisor makes a claim or statement in their disclosure document, and relies on a “written thing” to support the statement or claim, then the “written thing” must be retained by the franchisor for at least 6 years. This can be in paper or electronic format.

A “written thing” could be a document, report, website page, statistics, evaluations, forecast or anything at all in writing.

A franchise agreement must also not contain, or require a franchisee to sign, a waiver of any verbal or written representations made the franchisor.



Future Matters

If a franchisee alleges that a franchisor has made a representation about a future matter, it then becomes up to the franchisor to prove that they had reasonable grounds to make that representation. Future matters will cover representations such as anticipated profit or levels of trading. The franchisor must therefore have evidence to support making their representation.

Recent Cases

Reliance upon representations is common in franchising, and can be highlighted by some recent decisions of Courts.

In November 2014 the Federal Court found cleaning franchisor South East Melbourne Cleaning Pty Ltd (in



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liquidation), formerly Coverall Cleaning Concepts South East Melbourne Pty Ltd, guilty of contravening the Franchising Code of Conduct and in breach of the Australian Consumer Law. The franchisor engaged in unconscionable conduct, misleading and deceptive conduct and made false and misleading representations to two new franchisees. The franchisor had provided the franchisees with its 'Coverall Australasia Franchise Plan' which represented that franchisees could expect a certain volume of work to enable them to earn specified monthly amounts. The franchisor had no reasonable basis to make the representations about future matters.

The franchisor also, in breach of its franchise agreements, failed to pay the franchisees for cleaning services, whilst still demanding payment of the initial franchise fee. The franchisor was found to have taken advantage of the franchisees' significantly weaker bargaining power and the franchise agreements were therefore void from the date of order. The former director of the franchisor was found to have been knowingly involved in the franchisor's contraventions and was:

1. ordered to pay a penalty of \$30,000, compensate the franchisees \$23,000 for monies owing and franchise fees paid, and a contribution towards the ACCC's costs;
2. disqualified from managing a corporation for two years.

In the 2013 case of *Brotherson v Hursle Pty Ltd*, representations were made to a coffee van franchisee regarding the number of cups of coffee that would be sold daily. The franchisor guaranteed that the franchisee could sell 100 cups per day, and could easily sell 150 cups per day to generate the profit which the franchisee wanted. The franchisor represented that a feasibility study indicated the territory could support three franchisees. The franchisee soon discovered that these representations were false after they began to run the franchise. The feasibility study was not a study at all, but the franchisor's internet search of businesses within the territory, and then an estimate of the number of potential customers. The Court ordered the franchisor to pay them \$202,732.58 in compensation for loss suffered.

People who purchase an existing franchise must be careful not to rely on a former franchisee's representations. In the 2013 case of *Julstar Pty Ltd v Hart Trading Pty Ltd*, the new franchisee alleged that the former franchisee made representations to induce them to purchase and enter into the franchise agreement. These covered:

- The business' profits.
- The number of clients.
- That every franchise in the system was successful.
- That no franchise in the system had ever failed.
- That franchisees had a 100% success rate.



The new franchisee alleged that after they purchased the franchise from the former franchisee they never made a profit, and they learnt of disputes between the franchisor and other franchisees regarding targets not being met.

The new franchisee was unsuccessful in their arguments. The Court was not satisfied that representations by the former franchisee induced the new franchisee into the franchise. The new franchisee was a former employee of the franchisor, leading the Court to rule that they would have familiarity with the franchisor's business model and disputes with other franchisees. The new franchisee did not rely on their accountant's advice regarding profit and loss spreadsheets, and went on to enter into a related franchise agreement with the franchisor several months after entering the agreement in dispute.

A franchisor's representative made representations that the anticipated turnover of a franchise would be \$1.3 million in the 2012 case *Trans-It Freighters Pty Ltd v Billy Baxters (Franchising) Pty Ltd*. The representations occurred in the course of negotiations for a greenfield site, where it was represented that the site would be a good location for the franchise. The business suffered ongoing losses, and the statements were found to be misleading and deceptive conduct. The franchisees were entitled to \$1.22 million in damages because there was no basis for the representation.

In the 2012 case of *Miletich v Murchie*, a leasing agent made representations on behalf of a property developer to a franchisee regarding the level of expected trading in a shopping centre development. The Jamaica Blue cafe franchisees could not make a profit because many of the stores they had been told would be in the centre never opened and there was little foot traffic, resulting in a low trading level in the centre. The Court ordered the property developer and leasing agent to pay the franchisee \$398,557.39 for loss suffered because they had engaged in misleading and deceptive conduct.

The 2008 case of *Van Camp v Muffin Break* involved a franchisor who made representations about the suitability of a franchise location and the projected sales for the franchise. The franchisee went on to sign a franchise agreement, as well as a document which stated that no representations were relied upon. These were signed in rushed circumstances and the franchisee did not realise their significance. The franchisor was found to have made misrepresentations as to a future matter because there were no reasonable grounds or evidence to support the representations. The site had not been properly evaluated, and the franchisee was allowed to rescind the franchise agreement.

Lessons for Franchisors

Franchisors need to be careful not to mislead a potential franchisee and to keep in mind the consequences for misleading a franchisee about likely turnover, profit or any other matter on which the franchisee may rely.

If oral discussions occur prior to signing a franchise agreement, any representation made should be put into writing. This is important for both franchisors and franchisees. Written evidence is a lot easier to rely on if a dispute arises.

When a franchisee signs a franchise agreement, a prior representations deed should also be signed. This is a document that states that a franchisor has not made any representations to a franchisee, other than those recorded in the document. Franchisees should record any representations. The document should include a series of questions to prompt a franchisee to turn their mind to different forms of representations and to give the franchisee time to consider the questions.

Lessons for Franchisees

Franchisees should never rely on a representation regarding the potential for a franchised business without first undertaking their own research and investigations.

Franchisees should remember:

- Record any representation and make sure the franchisor is aware you are relying on the representation.
- Don't rush! Take your time.
- Talk to other franchisees.
- Get legal and accounting advice.
- Do due diligence.



At Bywaters Timms we can assist franchisors and franchisees to understand their rights and obligations when making or relying upon representations when entering into a franchise agreement. We can draft a prior representations deed for a franchisor, or review one for a franchisee before they sign it. If a franchise goes downhill and representations were made to a franchisee, we can assist franchisees or franchisors in taking the next step.