

# FRANCHISING

## LEGAL UPDATE

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## Warning For Franchisors

### Key message

*While every contractual arrangement has the potential of being transferred to a third party before it expires or is terminated by the original parties, the assignment and novation provisions of a franchise agreement should be carefully reviewed to ensure that whole of the franchise agreement can be transferred to any future incoming party.*

In the sale and purchase of a business, contracts are often assigned from the vendor party to the purchaser party. This includes in the sale and purchase of a franchise chain the individual franchise agreements.

Many franchise agreements provide the franchisor, being the party with the greater bargaining power, with numerous rights against the franchisee. Under the recent Federal Court decision in *Pacific Brands v Underworks*, some of those rights may be lost after an assignment of the franchise agreement.

### The case

The case considered whether Pacific Brands could terminate the intellectual property licence granted to Underworks (a competitor of Pacific Brands). Pacific Brands argued that when the relevant business was transferred, the right to terminate the licence had been assigned or novated to it.

The court held that the right to terminate was not capable of assignment on two grounds:

- » the right to terminate is a purely personal right (not a form of property) which cannot be assigned without the consent of the continuing party. The court also noted other rights - such as the power to review marketing plans and approve manufacturing facilities - which were not capable of assignment for the same reason

- » the right to terminate and other similar rights have an element of 'personal confidence', ie parties assumed that the powers and rights would be exercised personally by the original parties to the arrangement. If assigned to a third party, they could be exercised differently and in a prejudicial manner, especially where the assignee was a competitor.

This issue may be resolved by a novation of a contract, where a new party replaces an exiting party in substitution. The court held that a novation requires the following:

- » an agreement between the exiting party and the continuing party to discharge the existing agreement
- » an agreement between the continuing party and the new party to enter into a new arrangement substantially on the same terms as the agreement being discharged.

Such agreement was not found in this case.

### The impact

If *Pacific Brands v Underworks* is applied to the assignment of a franchise agreement, the assignee franchisor may not be able to terminate the agreement or exercise other rights, for example, in respect of systems compliance against a defaulting franchisee.

It should be noted that the licence agreement considered in this case did not provide the licensor an express right

to assign its rights under the agreement nor the requirement for the licensee's express consent to assignment. However, it contained a reference to the party's 'permitted assigns', which the court found to imply that permission or consent is required in respect of an assignment.

Every contractual arrangement has the potential of being transferred to a third party before it expires or is terminated by the original parties. Therefore, when

entering into a franchise agreement or when purchasing a franchise chain, the assignment and novation provisions of the franchise agreement should be carefully reviewed to ensure that whole of the franchise agreement can be transferred to any future incoming party. It is also recommended that franchise precedents and existing contracts be reviewed to ensure that their assignment and novation provisions do not become future deal breakers.

Jenny Lau | Solicitor

## Chicken Or Egg: Lessons From Lenard's

*The recent decision of the Full Federal Court of Australia in **Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd** overturns an earlier decision of the Federal Court, in which Poulet Frais was held to have engaged in misleading and deceptive conduct under section 52 of the **Trade Practices Act 1974**. The decision provides guidance and offers a method of protection to franchisors disclosing information to prospective franchisees.*

### Key message

*The decision is important for franchisors as it highlights their obligations under the Trade Practices Act and makes it clear that they must be careful in their dealings with prospective franchisees to ensure no representations are made.*

### Facts

The Silver Fox and Mr and Mrs Baker alleged that Poulet Frais engaged in misleading and deceptive conduct in the period leading up to the signing of the written franchise agreement for a Lenard's Poultry Shop by making representations regarding the profitability of its franchises and the quality of the site selection process. The judge at first instance held in favour of The Silver Fox and Mr and Mrs Baker.

The primary judge held the representation regarding profitability arose from financial information annexed to the franchise disclosure documents. The financial packages set out five different targets for gross weekly sales. The lowest target in each case was \$8,000 and the lowest annual net

operating profit was shown to be around \$50,000. The primary judge concluded that the information conveyed in these documents did represent the profitability of a Lenard's franchise. The representation concerning site selection was derived from an information pack provided to prospective franchisees stating, 'Lenard's choose shop locations carefully'.

The disclosure documents contained numerous recommendations to Mr and Mrs Baker and The Silver Fox to make their own investigations of the potential profitability of the franchise. There were also clear acknowledgements in the disclosure documents and the franchise agreement in which the Baker's signed that they did not rely on any representation as to the turnover or profits of the franchise.

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The Full Court found that neither representation was misleading or deceptive. In relation to the profitability representation they held that a reasonable person, having read and considered the whole of the documentary material provided by Poulet Frais, would not have thought Poulet Frais was representing to them that any particular weekly level of gross sales would be achieved.

The reasoning of the Full Court was also based on the number of disclaimers in the disclosure documents, the acknowledgement signed by the Baker's and the franchise agreement. In relation to the site selection representation the Full Court stated a reasonable person would consider that 'Lenard's choose shops locations carefully' meant Lenard's select shop locations with a view to profitability. Further it was found the site location was in fact selected carefully.

## Agency Considerations

Actual authority and general agency principles were also issues considered in this case. The primary judge found Poulet Frais was the agent of Lenard's for the purpose of providing the documentary materials to the Baker's in which the misrepresentations were said to have been made. The primary judge relied upon actual agency and not apparent or ostensible authority.

The Full Court said: "actual authority requires the consent of both the principal and the agent but the manifestation of consent may be express or implied".

The Full Court held there was no actual authority in this case as there was not consent or authorisation by Lenard's to Poulet Frais or Mr Hamood (a director) to deliver the financial packages to the Baker's. Further, even though Lenard's supplied the financial packages to Poulet Frais, the financial packages provided to the Baker's and Silver Fox were modified by Mr Hamood.

## Things to do now

Franchisors should consider:

- » reviewing the commentary contained in their Disclosure Document in relation to site selection (clause 11 of the Disclosure Document)
- » consider making it a mandatory requirement that Franchisees obtain independent legal advice and not simply recommending to Franchisees that they should seek legal advice. The Appeal Court placed weight on the fact that independent advice was sought.
- » undertake appropriate demographic analyses and feasibility studies for new areas or before opening stores in areas whose characteristics are significantly different to those experienced by current Franchisees. In the Lenard's case the Franchisee was going into a Shopping Centre in a newly developed area and there was an element of a first time experience for the Franchisor in this regard.

**Chris Nikou** | Partner  
**Sarah Standish** | Articled Clerk

## Quick Grabs

### Key message

*Employers are entitled to introduce a reasonable and relevant dress policy but must be aware of the potential pitfalls of doing so, but that in itself may not be enough to enforce compliance.*

### OH&S requirements in Victoria

The recent introduction of the new Occupational Health and Safety Act in Victoria means that Franchisors must now more than ever be diligent on OH&S issues. Section 4(2) of the New Act provides:

*“persons who control or manage matters that give rise or may give rise to risk to health and safety are responsible for eliminating or reducing those risks so far as reasonably practicable”.*

Many systems seek to control or manage the way in which their operators conduct their business. Franchisors often seek to control or manage such issues via the franchise agreement and more particularly the operational manuals. Middletons strongly recommends that you review this issue to determine whether or not you have risks in this regard.

**Peter Lupson** | Partner

### Third Line Forcing Amendments to TPA – Non Event

For some time it was likely that the Government was going to introduce amendments to the Third Line Forcing provisions of the TPA in line with recommendations made in the Dawson Committee Report. The proposed amendments will no longer proceed.

Accordingly, Franchisors should consider supply arrangements within their network to ensure that they do not infringe the Third Line Forcing provisions of the TPA.

**Caroline Carnegie** | Solicitor

### Dress standards in the workplace: Considerations for employers

A recent unfair dismissal case involving Safeway and one of its butchers illustrates that employers will not be able to enforce dress standards in all circumstances. It is therefore important that employers take a number of prudent steps if they wish to regulate the standards of dress that are worn in their workplace (including uniforms, jewellery, hair nets and others).

- » create a dress policy and distribute it to all employees at the time they commence employment
- » ensure the dress policy is related to the business of the employer and is reasonable having regard to the nature and circumstances of the employment
- » ensure the dress policy does not discriminate between sexes and complies with religious and cultural beliefs where possible
- » warn employees prior to dismissal.

**Chris Egan** | Solicitor

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