LAW LETTER

Rights.Rules.Regulations

September 2011

MacRobert Attorneys

Your strategic partner at law

This Spring edition of Law Letter as the 2011 Rugby World Cup tournament kicks off surveys recent court decisions on labour law, property rights, personal injury claims, tax law and looks at the impact of the Consumer Protection Act on franchise agreements. We also report on advocates practicing at the Bar in South Africa. Please remember that the contents of Law Letter do not constitute legal advice. For specific professional assistance, always ensure that you consult your attorney. We welcome your comments and suggestions.

LEGISLATION

Consumer Protection Act

■ *Franchise or Agency?*

OF ALL suppliers, franchisors are likely to most feel the sting of the new **Consumer Protection Act** of 2008. The Act expressly provides that the established threshold, which determines whether or not a transaction will fall within the scope and ambit of the Act, does not apply to a franchise agreement.

Unemployment plays a large hand in creating opportunities for entrepreneurs and an affordable franchise business usually makes for a very attractive venture. A new business, for example a fast food outlet, can receive a considerable boost and achieve economic viability if it is associated with an established brand. Typically, any potential restaurant owner faces considerable challenges in establishing and maintaining an independent outlet. It takes time to create the goodwill with which to sustain a business. But by entering into a franchise agreement, the restaurateur gains access to the franchisor's intellectual property.

"What exactly is a franchisor and who qualifies as a franchisor?"

In the fast food franchise industry, 'intellectual property' typically incorporates the following:

- **trade mark** – being the name and brand;
- **copyright** – subsisting in, among others, menus, recipes, designs;
- **methodology** – the manner of operating the business;
- **trade secrets, know-how and confidential information** – details of suppliers, training;
- **get-up** – the typical and well-known décor associated with a brand; and
- **goodwill** – reputation.

Where a start-up fast food outlet is allowed the use of such intellectual property and the association with an established brand, such outlet is almost guaranteed a certain degree of success.

In order to be granted the use of and to be able to apply such intellectual property, the franchisor and franchisee enter into an agreement in terms whereof, usually for payment of a monthly royalty, the franchisor licenses the use of such intellectual property to the franchisee.

Because any improper conduct by the franchisee could be prejudicial to the franchise group as a whole, very stringent measures are invariably put in place to protect the franchisor and oblige the franchisees to maintain a strict code of conduct relating to the products, the operation and the business in general. Franchise agreements are therefore generally perceived to be one-sided and biased because of their very authoritarian provisions. But this form of agreement has evolved to provide protection for the franchisor's most valuable asset, namely its intellectual property.

The Consumer Protection Act now disallows what is termed as 'unreasonable protection' or 'undisclosed benefits'. The agreement must be 'fair and reasonable' and '…in plain and understandable language'. The regulations to the Act provide for a vast number of essential terms and elements. They provide that the franchise agreement must disclose the residence, job titles and qualifications of all the franchisor's directors and equivalent officers.

At least 14 days prior to entering into a franchise agreement, the franchisor must disclose to the franchisee all the contact details of each and every other franchisee (including e-mail and telephone contact numbers) and a statement that the franchisee may contact and/or visit them to assess the information provided. Also, all statements reflecting the franchisor's financial position and growth, as well as the franchisor's expected growth, must be disclosed.

Then, most importantly, the franchise agreement itself must contain (at the top of the first page of the agreement) an express reference to Section 7(2) of the Act. This states that the franchisee may cancel the agreement, without any cost or penalty. This potentially could create a situation with dire consequences where a fast food franchisor has already set up premises, installed the fridges and other kitchen equipment, provided training and education and also disclosed all its

confidential information but then, ten days later, the franchisee simply elects to walk away, '…without cost or penalty'.

These provisions are a challenge to franchisors who could be exposed to a considerable extent. But this raises the question: What exactly is a franchisor and who qualifies as a franchisor?

The Act has introduced a significant change to the previous legal position. A franchisor is generally an entity which possesses certain intellectual property and licenses the use of such intellectual property to another who may, in consideration of a royalty payment, apply such intellectual property in strict accordance with the agreement, for a certain territory to the benefit of both the franchisor and franchisee. But the franchisee's business remains an independent business. It is the consumer who enters into an agreement with the franchisee,

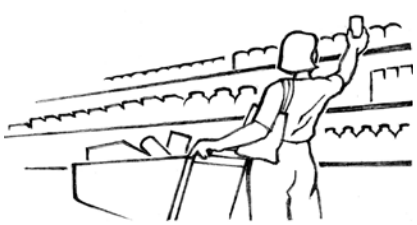
not with the franchisor. The franchisee and the consumer acquire certain rights and obligations to each other. In terms of the Act the consumer may also have recourse against the franchisor or other participants in the chain of delivery, but essentially it is the franchisee who enters into an independent agreement with the consumer.

It is important to determine whether or not a transaction is a franchise transaction for purposes of the Act. The Act defines a franchise transaction as one where the franchisee, for consideration paid to the franchisor, receives a license to carry on a business which utilises the system and associations provided by the franchisor and which transaction governs the business relationship between the franchisor and franchisee. However, the Act does not seem to take into account the independent nature of the business. The definition of a franchise transaction may now also extend to agencies.

The material difference between an agent and a franchisee is generally that an agent is not a party to the agreement. The relationship between an agent, its principal and the third party is that the agent merely represents the principal and the agreement is executed between the principal and the third party. The relationship between the agent and the principal is governed by an agency agreement or mandate. However, if the definition of a franchise transaction as defined in the Act is applied then the agreement between the agent and the principal may very well qualify as a 'franchise transaction'. The result of this, irrespective of the terms of the agency agreement, may be that the agent may enforce, against its principal, the very same protections as provided and prescribed by the Act for franchise agreements.

The distinction may lie within the definition of the term 'consideration paid'. A true agency agreement does not provide for a situation where the agent has to pay the principal for the right to apply its intellectual property. In fact, the agent is usually paid by the principal. The Act expressly provides for a situation where a 'franchisee' pays an amount to the 'franchisor' for the use of the intellectual property. The structure of the remuneration agreed upon is therefore essential to determine whether or not an agreement will qualify as an 'agency' or 'franchise' agreement. There are various agencies where an agent does have to make a payment, whether structured as a monthly payment or not, directly or indirectly, that allows the agent continued use of the principal's intellectual property. An example would be real estate agencies where agents pay to be associated with the principal. Another example could be a group of suburban housewives who are allowed to sell a range of plastic household containers by paying a small annual fee.

Principals or owners of agencies, whether distributorships, dealerships, estate agents, clubs or other businesses, should now take care to ensure that their agents do not contribute or give anything of value '…in exchange for…' the right to sell the principal's products, as such contribution could bring the agreement within the definition of a franchise agreement and will allow the agent all the entitlements that a franchisee may enforce against a franchisor.



FROM THE COURTS

Tax Law

■ *All Shall Be Equal*

"Let us never negotiate out of fear.
But let us never fear to negotiate."
– John F. Kennedy (1912 - 1963)

THE COMMISSIONER for the South African Revenue Service (SARS) used Section 78(1) of the **Income Tax Act** of 1962 to estimate income tax due by Mr Mokoena. This section provides that where the commissioner is not satisfied with information furnished by any person, the commissioner may estimate the taxable income in relation to which the information is required. Mokoena objected to the assessment and while the objection was pending, the commissioner used Section 91(1)(b) of the Act to apply for judgment for that amount. That section provides that if any person fails to pay any tax when it becomes due,

the commissioner may file with the registrar of any competent court a statement certified by him as correct and setting forth the amount of the tax due, and such statement shall have all the effects of a civil judgment.

Judge Spilg sitting in the South Gauteng High Court in Johannesburg agreed that it was clearly competent to demand and collect an assessed capital sum, which was done by reason of the pay now, argue later principle. However it was not competent, having regard to the rights of objection and appeal which the taxpayer has, to obtain judgment in the interim. That would be inconsistent with the framework of the Act and its provisions. For example, the express right to collect tax despite an objection and appeal would be unnecessary if judgment could be obtained in the interim.

The judge held further that in order to provide adequate safeguards to the way Section 91(1)(b) was used, the statement submitted by the commissioner to the registrar of a competent court should indicate clearly:

- Whether the assessment relied upon was an estimated assessment under the exercise of the powers conferred under Section 78(1);
- If so, the suitability of the qualifications and experience of the person to conduct the estimated assessment; and
- That the responsible person had satisfied himself from the records maintained by SARS that no objection or appeal was pending, or, if lodged, had been finally disposed of, so that there was no impediment to filing the statement.

Mokoena's application was upheld and the judgment granted against him was set aside and declared null and void. The commissioner was called upon to show cause why he should not be liable for the costs of the application.

Mokoena v. Commissioner, South African Revenue Service 2011 (2) SA 556 (GSJ).

Property Rights

■ *Mine over Matter*

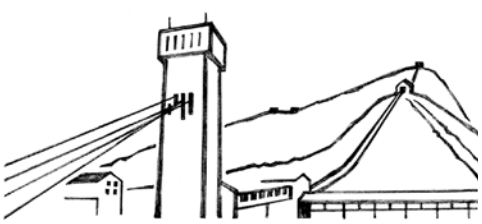
MINERAL RIGHTS were expropriated through the coming into effect of the **Mineral and Petroleum Resources Development Act** of 2002. As a result of this expropriation the State has a constitutional duty to pay compensation.

This is what Judge Ben du Plessis decided in the North Gauteng High Court in a case brought by Agri SA against the Minister of Minerals and Energy, now the Minister of Mineral Resources.

This important judgment confirms the fundamental principle that property may not be expropriated without compensation, as stipulated in Section 25 of our Constitution.

Agri SA instituted this action after taking cession of Sebenza Mining's claim arising from expropriation. Sebenza Mining was the holder of mineral rights on 30 April 2004, immediately prior to the coming into effect of the Act. The claim was brought as a test case in order to obtain clarity on certain principles through a judgment by the court. When the Act came into effect on 1 May 2004 all common law mineral rights lapsed and the State became the custodian of all minerals for the benefit of all South Africans.

The Minister defended the claim by alleging that the coming into effect of the Act did not result in an expropriation but simply enabled the State to regulate the country's mineral resources. In the alternative the Minister contended that,



should the court find that an expropriation did occur, it would be fair and reasonable not to award any compensation, due to, amongst others, the allegation that the State cannot afford to compensate all potential claimants whose rights were expropriated.

The court however determined that the purpose of the Act could not have been achieved without an expropriation of the mineral rights and accordingly an expropriation did occur on 1 May 2004.

With regard to the compensation payable by the State, the judge's view was that the market value of the mineral right represents a fair and reasonable compensation. The State cannot avoid its responsibility to pay compensation by alleging that it cannot afford it. When the State expropriates, it should do so within its means.

The Minister has since appealed the judgment and leave to appeal was granted.

This landmark decision, although still subject to appeal, clears the way for all those who lodged claims against the State in terms of the Act to be successful with their respective claims.

Even more important than the benefit of the judgment for these claimants is the legal certainty it provides and the fact

that it confirms the protection of property rights in South Africa under the Constitution.

Agri South Africa v. Minister of Minerals and Energy and Another (55896/07) [2011] ZAGPPHC 62.

Labour Law

■ *Business Class*

"All the rights secured to the citizens under the Constitution are worth nothing, and a mere bubble, except guaranteed to them by an independent and virtuous Judiciary."
– Andrew Jackson (1767 - 1845)

ONE OF the fundamental principles of law is the principle of separation of powers. It underscores the system of checks and balances set out in the Constitution, which is of course the highest law of the land. It is designed to ensure that the three arms of government – the legislature, the executive and the judiciary – operate independently from one another to ensure that power is not abused by any one of these arms.

A tendency has however emerged within the judiciary, specifically the judges of the equity courts, to blur the lines between the judiciary and the legislature, in defence of the rights of vulnerable individuals. One of these cases is the Labour Appeal Court's decision in a dispute between the Aviation Union and SAA which concerned the interpretation of Section 197 of the **Labour Relations Act**. This section has as its intention the protection of the rights and job security of employees when an employer transfers his business as a going concern to another entity. The section provides that where a transfer takes place by an old employer to a new employer the contracts of employment of the employees are automatically transferred to the new employer.

The question that came before the Labour Court was whether the outsourcing by SAA of a part of its business to a new service provider, whilst cancelling the contract of an existing service provider, amounts to a Section 197 transfer. More specifically, was this a transfer from the old service provider to the new service provider, or was it a transfer from SAA to the new service provider. The Labour Court had decided that a proper interpretation of the wording of the section does not include a transfer from one service provider to another as the transfer that takes place is not by the old employer. The Labour Appeal Court disagreed. Its view was that it was necessary to follow a purposive approach to the interpretation and that the word "by" in the section should really be interpreted to read "from".

The Supreme Court of Appeal however ruled that it is not appropriate for a court of law to read into a statute which has been passed after intense consideration and debate, words that the legislature had not chosen to include. This would be tantamount to the court usurping the role of the legislature. In coming to this decision the Supreme Court of Appeal confirmed that a purposive approach should only be followed in the interpretation where the plain wording of the statute is unclear or ambiguous.

Aviation Union of SA obo Barnes & others v. SA Airways & others (2009) 30 ILJ 2849 (LAC).
SA Airways (Pty) Ltd v. Aviation Union of SA & others (2011) 32 ILJ 87 (SCA).

Personal Injury

■ *Ambulance Chaser*

"The Golden Rule is that there are no golden rules."
– George Bernard Shaw (1856 - 1950)

A COLLISION OCCURRED in a hospital parking lot involving a six-seater golf cart shuttle causing injuries to two persons. A claim was brought for compensation in terms of the **Road Accident Fund Act** of 1996. But it was pleaded that the battery powered golf cart was not a "motor vehicle" as defined in Section 1 of the Act. As a result it was argued that the Road Accident Fund was not liable as the Act did not apply.

Section 1 of the Act defines a motor vehicle as:

> "Any vehicle designed or adapted for propulsion or haulage on a road by means of fuel, gas or electricity, including a trailer, a caravan, an agricultural or any other implement designed or adapted to be drawn by such motor vehicle."

Acting Judge Goodey analysed the applicable law and considered the characteristics of the golf cart. He referred to previous cases. He observed it is a fact of life that "motor vehicles", in the normal and ordinary sense, move around in parking areas of hospitals, resorts, parking lots, airports and other areas to which the public have access. What is more

important is that pedestrians and "shuttles" like the golf cart in this case also move around in ever increasing numbers in these areas. Common sense and the reality of the situation call for these "shuttles" to be classified as "motor vehicles".

The judge ruled that the shuttle in question is a motor vehicle in terms of the Act.

Berry & Another v. SPE Security Patrol Experts & Another 2011 (4) SA 520 (GNP).

Bar Counter

■ *Advocates in South Africa*

THE SOUTH African population is approximately 50 million people. According to the membership statistics of the General Council of the Bar of South Africa as at 30 April 2011, there are only 2268 advocates.

– 1754 are Males, 514 are Females.

– 1684 are Whites, 327 are Blacks, 78 are Coloureds, 179 are Indians.

– 2052 of the advocates practice in the major metropolitan areas - 823 in Johannesburg, 513 in Pretoria, 437 in Cape Town, and 279 in KwaZulu-Natal.

– The remaining 216 advocates are thinly spread around the country - 64 in Port Elizabeth, 63 in Bloemfontein, 26 in Grahamstown, 23 in Mthatha, 16 in Bisho, 13 in Mafikeng, and 11 in Kimberley.

– 455 advocates are Senior Counsel, 1188 have five years or more experience, 452 have less than 5 years experience, and 173 are not in active practice.

There are also some advocates who do not belong to the General Council of the Bar. Although the law faculties of our universities produce thousands of law graduates every year, clearly few of them succeed in the challenging and demanding Bar environment.

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