QCAT

Queensland Civil and Administrative Tribunal

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| **CITATION:** | *Melenewycz v Queensland Building and Construction Commission* [2014] QCAT 100 |
| **PARTIES:** | Peter Clark Melenewycz<br>(Applicant)<br>v<br>Queensland Building and Construction Commission<br>(Respondent) |
| **APPLICATION NUMBER:** | OCR284-12 |
| **MATTER TYPE:** | Occupational regulation matters |
| **HEARING DATE:** | 3 March 2014 |
| **HEARD AT:** | Brisbane |
| **DECISION OF:** | **Senior Member Oliver** |
| **DELIVERED ON:** | 21 March 2014 |
| **DELIVERED AT:** | Brisbane |
| **ORDERS MADE:** | **1. The decision of the Commission made on 26 June 2102 is set aside.**<br>**2. The applicant be categorised as a permitted individual.** |
| **CATCHWORDS:** | PERMITTED INDIVIDUAL – where applicant a director of a company that entered into a franchise agreement – whether the company took reasonable steps prior to entering into the agreement – whether all relevant facts and representations disclosed to the applicants legal advisor – whether the building company sufficiently capitalised.<br><br>*Queensland Civil and Administrative Tribunal Act* 2009 (Qld) s 20<br>*Queensland Building and Construction Commission Act* 1991 (Qld) ss 56AD(8), 56AD(8A)<br><br>*Younan v Queensland Building Services Authority* [2010] QDC 158 |

**APPEARANCES and REPRESENTATION (if any):**

**APPLICANT:** In person

**RESPONDENT:** Mr Robinson of Robinson Locke Lawyers

**REASONS FOR DECISION**

[1] Mr Melenewycz was a director of AM PM Constructions Pty Ltd ('the Company'). On 12 May 2012 a liquidator was appointed to the Company and as a result Mr Melenewycz, who held a licence under with the Queensland Building and Construction Commission, was categorised as an excluded individual under s 56AC of the *Queensland Building and Construction Commission Act* 1991 (Qld). This meant that his licence would be cancelled unless he applied to be categorised as a permitted individual under s 56AD of the Act. On 26 June 2012 the Commission rejected his application because it was not satisfied that, under s 56AD(8), he '*took all reasonable steps to avoid the coming into existence of the circumstances that resulted in the happening of the relevant event*' here the liquidation of the Company.

[2] From that decision, Mr Melenewycz filed an application for review in the Tribunal. The Tribunal's function on an application to review an administrative decision is to produce the correct and preferable decision by way of a fresh hearing on the merits.[1]

**Background**

[3] Some history as to the circumstances leading to the liquidation of the Company is necessary to understand how the Company fell into financial difficulties.

[4] The Company carried on business for many years as a home renovation business prior to the global financial crisis which occurred in 2008. It was quite successful and as a consequence Mr and Mrs Melenewycz managed to accumulate some assets. These included a house at Victoria Point, and a block of land in Ipswich marked for future development. However, with the onset of the global financial crisis Mr Melenewycz's building business conducting home renovations completely dried up and despite his best efforts could not generate any new work because of a general feeling of uncertainty in the economy.

[5] In an attempt to put himself and the Company in a position where work might be generated, he investigated entering into a franchise opportunity with Smith and Sons Renovations Pty Ltd. Mr Melenewycz had discussions with Mr Geoff Thompson, a sales person for Smith and Sons engaged to promote the franchise to potential builders, about the franchise. These discussions occurred in 2010. At that point, Mr

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[1] *Queensland Civil and Administrative Tribunal Act* 2009 (Qld) ('QCAT Act') s 20.

Melenewycz told the Tribunal that he was desperate for work to generate cash flow and be able to pay expenses including the wages of an employee apprentice. I have no reason to doubt this evidence.

[6] The franchisor promised that the Company would have an exclusive area of Brisbane to operate its business and any calls coming to the franchisor for work in the designated area would be automatically diverted to Mr Melenewycz. To ensure that there was a professional appearance to the operation of the business, the Company was required, under the franchise agreement, to open a shop front from which to conduct the business. Customers could also attend the business premises to discuss plans and obtain quotes for work.

[7] A key feature of the franchise was the system for quoting and costing a building project and the management of the project through the system. Mr Melenewycz did not have any specific detail of this system before signing the franchise agreement because it was Smith and Sons intellectual property and it was only upon entering into the franchise agreement, would he be given access to the specific information about their operating system.

[8] Mr Melenewycz was not naive about entering into the franchise agreement. He told the Tribunal that he and his wife discussed the operation of the franchise with other independent franchisees who were satisfied with the way the franchise was operated, the quantity of work that came in through the 1300 number and the overall system in place. When asked if they would go into the franchise agreement again, they all responded in the affirmative.

[9] Unfortunately, Mr Melenewycz could not identify the specific people he spoke to because it happened so long ago but I have no reason not to accept his evidence on this point. In addition to making the specific enquiries, he also had his solicitors examine the franchise agreement and provide advice to him. That is not only confirmed from his own evidence, but there are statements of fees from the solicitors for the work undertaken and, as a consequence of that, the solicitors changed certain parts of the franchise agreement before it was signed.

[10] Mr Melenewycz also spoke to his accountant Brian Palesy who had been the Company's accountant for sometime. Because of the difficulty in generating business after the global financial crisis, Mr Palesy advised him that entering into a franchise agreement would likely provide a source of work for him and was a '*good idea*'. The alternative was to continue to struggle to generate work for the Company.

[11] As I have already indicated Mr Melenewycz was not naïve. He did not simply accept all of the representations made Mr Thompson without reservation.

[12] At the time of entering into the agreement in June 2010, Mr and Mrs Melenewycz had significant equity in their house at Victoria Point (about

$200,000), equity in the parcel of land at Ipswich and also Mr Melenewycz had significant experience in the operation of a small business. He has a trade qualifications in sheet metal work and carpentry and is a registered builder. He has also completed a diploma in small business accounting. Mrs Melenewycz helped with doing the books of account for the Company throughout the operation of the business both before and after the franchise agreement was signed.

[13] Subsequent to signing the franchise agreement both Mr and Mrs Melenewycz attended two-week course conducted by Smith and Sons on the Sunshine Coast. This course was to show them how the '*failsafe system*' operated and how the system was supposed to provide accurate quoting and project administration. Mr Melenewycz was frank in saying that he thought the system was hopeless and afterwards when he started to operate the business, did not rely on the system but used the quoting system that he had always used in his own construction industry. He told the Tribunal that he tried many times to understand how the system operated, spent many hours trialling the system, sought advice from the franchisor but could not get it to operate satisfactorily. Once again I have no hesitation in accepting Mr Melenewycz's evidence on this point.

[14] The advantages of the franchise to the Company was supposedly; the operating system which was to save costs, significant group buying power which would provide discounts from suppliers for building materials, and the central enquiry point of Smith and Sons' 1300 telephone number meant all enquires about jobs in the franchise area would be directed to the Company. The Company paid $40,000 to enter into the agreement.

[15] The ongoing costs payable to the franchisor to remain in franchise group was a payment, under cl 4.1 of the agreement of '*six per cent (6%) of the aggregate jobs in the system (or contracts) started or commenced during the proceeding month by the Franchisee (exclusive of GST, if any)*'. As it turned out the franchisor did not insist on strict compliance with this clause whilst the business was starting up.

[16] The accounts for the first year of the operation of business demonstrates that it was initially successful. There were gross sales for $528,582 with expenses of $523,845. This resulted in a net profit of $24,591.

[17] Although it was a requirement to set up a shop front this was not done until the second year of the operation of the franchise in June 2011. The expenses in the profit and loss statement show rent of $4,333 which is consistent with Mr Melenewycz's evidence on this point. Again I accept this evidence. Not only was there rent payable on the shop front, the cost of the shop fit out was $30,000, a bond of $7,500 and then the ongoing rent.

[18] I should mention the floods. In January 2011, as is well known, the Brisbane area was subjected to a significant flood event. Although this did not have any direct impact on the availability of work, what it did do was significantly reduce the value of Mrs Melenewycz's Ipswich property. This

was a property, which provided a capital basis for the operation of the business through its equity. The evidence is that its value dropped from over $1 million down to about $200,000. Those figures, are unsupported and might be slightly exaggerated however, I can take into account that there was a significant erosion of the equity in this property as a result of the floods that devastated Ipswich and the surrounding areas. Similarly, the equity in the Victoria Point property dropped as a result of a downturn in the housing market.

[19] That history of entering into the franchise agreement, the operation of the business in the first year, the opening of the shop front, erosion of equity in the underlying assets supporting the business were all matters which were relevant to what occurred in or about November 2011.

[20] By November 2011 the evidence from Mr Melenewycz is that the work simply dried up. Although the figures demonstrate that there was a reasonable cash flow in the first 12 months, no further work came into the business from November through to the date of liquidation. One job kept them going through to May 2012 but Mr Melenewycz said that by the end of November he knew that there was trouble brewing. They exhausted all of the equity that was available in their property to support the overdraft they had with the ANZ bank of $30,000 together with a credit card limit of $15,000. In September they entered into a tax arrangement with the Tax Office to pay outstanding GST on a monthly basis and ended up paying that outstanding balance.

[21] In the later part of 2011 Mr Melenewycz met with other franchisees to discuss how they could generate business. He said the Company spent about $10,000 on unexpected advertising to try to generate work this included handing out leaflets with pizzas at the local pizza parlour, advertising on Brisbane City Council Buses, and embarking on television and newspaper advertising. There was no assistance given to the franchisee by the franchisor in trying to generate work. In addition the franchisor was insisting on the full six per cent payment to it of new work generated after 1 July 2011. Mr Melenewycz said that the group discount buying system did not offer any advantage at the end of the day and the usual builder's margin of 10 per cent was reduced to 15 per cent under the operating system of the franchisor which made margins tight.

[22] Despite all of the efforts engaged in by the Melenewycz's no new work was generated after November and by May 2012, they sought advice about trying to come to some arrangement with creditors. They were advised that the Company was insolvent and it was therefore put into liquidation.

**What are the circumstances that resulted in the relevant event?**

[23] The Commission contends that there were three causes. The first cause was entering into the franchise agreement which turned out to be unfavourable and unsatisfactory. It is suggested that this is the dominant cause.

[24] The second cause is the conduct of the franchise turning out to be different from expectations. It is contended that this equates to a misrepresentation by the franchisor.

[25] The third cause is under capitalisation of the business from the very beginning. This is demonstrated by the figures in the balance sheet.

[26] Mr Melenewycz says that the cause of the relevant event was primarily the lack of work after November 2012 which could not have been predicted when the Company entered into the franchise agreement, and was inconsistent with past performance. To some extent he says that the franchise agreement did not operate in his favour and that there was a misrepresentation to the extent that work was not generated by the franchisor as would be expected, and secondly the operating system was not as represented. Another factor is possibly the tight margins that were supposed to have been offset by the discounts resulting from the group buying power were not as represented.

[27] Identifying the cause of the relevant event in terms of s 56AD(8) is important because the evidentiary onus is on the applicant to satisfy the decision maker, here the Tribunal, that it took all reasonable steps to avoid the coming into existence of the circumstances that resulted in the happening of the relevant event. Also, in considering whether an applicant did take all reasonable steps the decision maker is required to have regard to s 56AD(8A) which sets out specific matters to be taken into account they include:

> (a) keeping proper books and account and financial records;
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> (b) seeking appropriate and financial and legal advice before entering into financial or business arrangements or conducting business;
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> (c) reporting fraud or theft to the police;
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> (d) ensuring guarantees provided were covered by sufficient assets to cover the liability under the guarantee;
>
> (e) putting in place appropriate credit management for amounts owing and taking reasonable steps for recovery of the amount;
>
> (f) making appropriate provision for Commonwealth and State taxation debts.

[28] The causes identified by the Commission, and to some extent those identified by the applicant are generally picked up in this sub-section.

[29] The test for determining if an applicant did take reasonable steps to avoid the coming into existence of the circumstances that resulted in the happening of the relevant event McGill DCJ in *Younan v Queensland Building Services Authority*:[2]

> The test in s 56AD(8) requires first, the identification of the relevant event; second, the identification of the circumstances that resulted in the happening of the relevant event; third, a consideration of whether the

[2] [2010] QDC 158.

> relevant individual took all reasonable steps to avoid those circumstances coming into existence; and, if satisfied of that, fourth, a decision whether to categorise the individual as a permitted individual. What were reasonable steps depended on what was reasonable for the individual concerned in the circumstances in which he found himself, with such information as he then had. It is not a question of whether he did everything possible to prevent these circumstances from arising, or whether they would not have arisen if he had acted differently. The reasonableness of his behaviour must be assessed by reference to what was known by him at the time, without the benefit of hindsight.

## Findings

[30] I have already set out the circumstances that lead the Company to enter into the franchise agreement with Smith and Sons. The franchise offered a means of generating work and provided, to some extent, a safety net, of ongoing work through a central call centre and 1300 number. Mr Melenewycz has demonstrated that prior to the consideration of going into the franchise he had no work and had not had any work for some months.

[31] Mr Melenewycz thoughtfully considered whether the franchise was the appropriate way forward for the Company and after taking advice from his lawyers and accountant, and speaking to other franchisees he decided to go ahead with the franchise agreement.

[32] The only criticism that can be levelled against Mr Melenewycz is that he did not fully explain the representations to his legal advisors to get advice as to whether those representations were inconsistent with the terms of the agreement because the agreement contained an '*entire agreement clause*'. It is all very well to make that submission after the event. Bearing in mind that Mr Melenewycz did not present as someone who was gullible to any representation made, I am satisfied that he gave his lawyers sufficient information for them to make an informed decision, not only about the terms of the franchise agreement to which some changes were effected, but also on the utility of embarking on this cause in circumstances where work was not otherwise available.

[33] I accept Mr Melenewycz's evidence that he did all that could be reasonably expected of him in investigating the benefits of entering the franchise agreement by obtaining appropriate advice from various parties and making his own independent enquiries. As this is promoted as a cause of the relevant event, I am satisfied that he took all reasonable steps to avoid the circumstances resulting from the unfavourable franchise agreement.

[34] As to the contention that the franchise turned out to be different to expectations, there is not very much, more that Mr Melenewycz could have done to improve the circumstances. Once he had to open the shop front, pay the fit out costs, and incur additional expenses, as he was contractually obliged to do, there was an immediate drain on cash flow and capital. After he realised that the work coming in was slowing down,

he and other franchisors took immediate steps to address this problem and he also sought relief from the franchisor in respect of the six per cent franchise fee. The lack of work was completely out of his control and he could not have reasonably been expected, at the time he signed the agreement, to know that the '*fail safe system*' was not in fact fail safe and offered no advantage in terms of profitability. Also, he could not have known that the group buying power did not offer any greater financial benefit than going direct to his own suppliers as he had done prior to entering into the franchise agreement. I don't see this as a cause that resulted in the event and if it was then he took reasonable steps to avoid it by embarking on an advertising campaign to try and overcome the failure by the franchisor to provide the work, through the call centre, as promised.

**Was the business under capitalised?**

[35] There can be no doubt that there were sufficient assets at the commencement of the franchise to underpin the operation of the business. There was significant equity in two properties that were used by the Melenewyczs' to secure loans to the Company. The 2011 floods wiped out a large part of that equity but despite this, the Company still continued to operate and generate a significant income for the 2011 financial year and made a profit. Certainly on a prediction of the subsequent year it would be reasonable to suppose that the Company would generate an equal number of sales if not more, because the franchise agreement required the turnover to increase despite there being additional expenses by way of rent and fit out of the office the shop front.

[36] There might be some discrepancies in the balance sheet of the Company but Mr Melenewycz, as he was entitled to do, relied on the accountant to prepare the accounts and again I accept his evidence on this point. I am not satisfied that the business was so under capitalised, even after the diminution in equity to come to a conclusion that he did not take reasonable steps to ensure that the business was properly capitalised when it was commenced. As for taxation liabilities, there did come a point in September 2011 when the Company fell behind in taxation liabilities. Immediately an arrangement was made with the Tax Office, made in circumstances where the Company could clearly support the repayment program put in place and in fact made the payments and therefore that satisfied the sub-section that proper provision was made. The subsequent arrangement in March 2012 was at a time when the Company was in significant financial difficulties and that arrangement was not a cause of the eventual appointment of liquidators.

**Conclusion**

[37] In summary therefore I have come to the opinion that Mr Melenewycz as a director of AM PM Constructions Pty Ltd has taken all reasonable steps to avoid the circumstances that resulted in the liquidation of the Company and, even in hindsight, there is little more he could have done to prevent the appointment of liquidators.

[38] The decision of the Commission made on 26 June 2102 is set aside and instead there will be a decision that Mr Melenewycz be categorised as a permitted individual.