

**From:** [REDACTED]  
**To:** [Franchising Review](#)  
**Subject:** Submission: Review of the Franchising Code of Conduct.  
**Date:** Friday, 22 September 2023 4:46:21 PM  
**Attachments:** [Girchow Enterprises Pty Ltd v Ultimate Franchising Group Pty Ltd \(Final Hearing\) \[2023\] FCA 420 \(1\).pdf](#)  
[REDACTED]

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To the Treasury,

I am writing as a former franchisee to provide my perspective and thoughts on the franchising code.

I had been a franchisee of UFC GYM Australia until earlier this year. Myself along with 2 other separate franchisees brought a claim to the federal court of Australia contending that the franchisor engaged in misleading behaviour and misrepresentation. The federal court found in our favour and provided orders for over \$6 million in combined damages and for the franchise agreements to be terminated.

I have attached the judgement for your reference.

My submission is in relation to section E of the consultation paper: **Enforcement and dispute resolution.**

While we commenced our respective franchise agreements in 2017 and 2018, within the first year it had become clear that the reality of being a franchisee bore no resemblance to what was disclosed in the franchise agreements and disclosure documents. In particular the following items were either misrepresented or excluded entirely.

- Non-disclosure of the CEO and director Maz Hagemrad's previous federal court ruling for misrepresentation in a separate franchising issue. In effect Maz had manipulated the profitability of a franchise business to a seller by entering fake sales. This case was not mentioned at all.
- Misrepresentation of establishment costs. Maz in meetings and in writing on the disclosure document presented a start up cost of between \$600,000-900,000. The true cost was approximately \$1.5 million. Maz was not able to show in court how he was able to claim the lower start up cost, particularly when he had already established 2 clubs.
- Non-disclosure and misrepresentation of operational expenses. Maz and the directors hid in meetings and on the disclosure documents, companies that were mostly operated by Maz' family members. Franchisees were forced to use these suppliers (under the threat of breach for non-compliance) and then these companies proceeded to charge double to quadruple market rates for their services. These services along with many others meant that franchisees lost \$10,000 per month on average with no real prospects of profitability. This was in contrast to the profitability projections provided by Maz Hagemrad which in my case projected substantial profitability in year 1. The figures provided varied from the true figures substantially.
- Non-disclosure of relationships with suppliers. As above these companies were not disclosed and the family relationships were hidden until later discovered by other franchisees. These companies included a shipping company operated by his wife (Strategy Squared), the builder who was his brother in law (Intrex Projects), electrician who was his cousin (Amazed Electrics) and a claimed processing company (MSA) which was effectively a shell company directly owned by Maz himself.

Once the above were discovered all franchisees at that time formed a committee brought their complaints, requesting for some royalty relief (as all franchisees were losing approx \$10,000 per month under the weight of the undisclosed costs) and removal of unnecessary services and fees operated by the directors (MSA).

The meeting was held by one of the director who denied any relief nor offered to make any changes. In reality not long after the meeting the franchisor added additional fees and costs, largely perceived by franchisees as retaliation for our complaints.

Given the above 3 franchisees including myself commenced legal action. This cost us a combined \$800,000 in legal fees and took 4 years to reach judgement. Through these 4 years we continued to suffer huge losses on our businesses and the franchisor repeatedly made threats of and made submitted actual frivolous breaches including for example not having a television turned on during operational hours. None of the breaches were substantial and in most cases even accurate however it required additional legal costs on our part to defend each time.

Although it may appear that we achieved a favourable federal court judgement the franchisor was able to act with impunity throughout.

Further, the franchisor has it appears anticipated the findings and had taken steps to protect personal assets by moving all their assets to spouses and establishing a network of shell companies to move their funds. As a result the franchisor and directors (who were found jointly liable) have not paid any monies resulting from the judgement.

The following week they entered voluntary administration [REDACTED] they were able to vote in a DOCA that would hand back the company to the directors and for the directors to avoid all liability for the orders and the creditors be paid 1c on each dollar owed. This DOCA vote involved creditors representing over 85% of debt in value being out-voted by the directors and their related parties [REDACTED]. We are now in the process of applying to court to have the DOCA overturned. [REDACTED]

In effect the directors have made millions in ill-gotten profit from franchisees and have been able to escape any actual penalty through their ability to drag out the legal process, use of shell companies and trust to hide their assets [REDACTED] to take back the company without any true cost.

Below is an indication of the impact to all the known franchisees. The franchisor has also not disclosed known franchisees from disclosure documents in another breach of the code. It is clear from below why they would not disclose this. They are listed in order of when the franchisee joined the system.

1. Fountain Gate (Melbourne) - Gym closed in 2022 after 4 years due to heavy financial losses. Was at no stage profitable/
2. Penrith (sydney) - Gym closed in 2022 after 3 years due to heavy financial losses. Was at no stage profitable.
3. Marsden Park (Sydney) - never opened. Initiated legal action once they discovered they had been misled on costs and settled out of court.
4. Campbelltown (Sydney) - never opened. Initiated legal action once they discovered they had been misled on costs and settled out of court.
5. Gregory Hills (Sydney) - current active franchisee.

6. Newcastle - never opened. Initiated legal action once they discovered they had been misled on costs and settled out of court.
7. Blacktown (Sydney) - Gym closed in 2023 after federal court order terminating franchise agreement. This was my club. Was at no stage profitable.
8. Balcatta (Perth) - Gym closed in 2023 after federal court order terminating franchise agreement. This was my club. Was at no stage profitable.
9. Castle Hill (Sydney) - Gym rebranded in 2023 after federal court order terminating franchise agreement. This was my club. Was at no stage profitable.
10. Macarthur Square (Sydney) - went into voluntary administration in 2023 after 1 years operation.
11. Rockdale (Sydney) - currently in negotiations to have franchise agreement terminated. Have initiated legal proceedings.
12. Ashmore (Gold Coast) - currently in negotiations to have franchise agreement terminated. Have initiated legal proceedings.

Thank you for considering my submission, I hope that the story of UFC GYM Australia can demonstrate how a sophisticated franchisor can profit from deception and act with impunity. Individuals with experience of the franchise system as these directors were, understand that it is extremely difficult for a franchisee to hold the franchisor accountable and that they do not have any need to adhere to the franchising code. The severe imbalance of power between the franchisor and franchisee was not mitigated in the case of UFC GYM in any meaningful way by the current code.

# FEDERAL COURT OF AUSTRALIA

## Girchow Enterprises Pty Ltd v Ultimate Franchising Group Pty Ltd (Final Hearing) [2023] FCA 420

File number(s): NSD 395 of 2020

Judgment of: **THAWLEY J**

Date of judgment: 5 May 2023

Catchwords: **CONSUMER LAW** – misleading and deceptive conduct – whether three corporate franchisees entered into gym franchise agreements because of misleading conduct on the part of franchisor and its directors – whether individuals gave guarantees because of misleading conduct – alleged representations with respect to future matters, mostly concerning likely future income and likely establishment costs – held that franchise agreements and guarantees entered into because of misleading conduct

**DAMAGES** – appropriate quantification of losses where establishment costs expended on setting up unprofitable businesses – whether value of businesses when set up equalled costs incurred in setting up the businesses – whether referee report should be adopted – referee report adopted in part

**EVIDENCE** – discussion of difficulties caused by cutting and pasting evidence from one affidavit to another

Legislation: *Competition and Consumer Act 2010* (Cth) s 139B, Sch 2 (*Australian Consumer Law*) ss 4, 18, 236, 237  
*Federal Court of Australia Act 1976* (Cth) ss 37P(2), 54A

Cases cited: *Australian Competition and Consumer Commission v Woolworths Ltd* [2019] FCA 1039  
*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200  
*Butcher v Lachlan Elder Realty Pty Ltd* [2004] HCA 60; 218 CLR 592  
*Campbell v Backoffice Investments Pty Ltd* [2009] HCA 25; 238 CLR 304  
*Chocolate Factory Apartments Ltd v Westpoint Finance Pty Ltd* [2005] NSWSC 784  
*City of Botany Bay Council v Jazabas Pty Ltd* [2001]

NSWCA 94; [2001] ATPR 64-210  
*HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd*  
 [2004] HCA 54; 217 CLR 640  
*I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd*  
 [2002] HCA 41; 210 CLR 109  
*Kane's Hire Pty Ltd v Anderson Aviation Australia Pty Ltd*  
 [2023] FCA 381  
*Kizbeau Pty Ltd v WG & B Pty Ltd* [1995] HCA 4; 184  
 CLR 281  
*McGrath v Australian Naturalcare Products Pty Ltd* [2008]  
 FCAFC 2; 165 FCR 230  
*Murphy v Overton Investments Pty Ltd* [2004] HCA 3; 216  
 CLR 388  
*Potts v Miller* (1940) 64 CLR 282  
*Shah v Hagemrad* [2018] FCA 91  
*Sykes v Reserve Bank of Australia* (1998) 88 FCR 511  
*Tour Squad Pty Ltd v Fifth Amendment Entertainment Inc*  
*(No 2)* [2021] FCA 546; 151 ACSR 607  
*Wardley Australia Ltd v State of Western Australia* [1992]  
 HCA 55; 175 CLR 514

Division:	General Division
Registry:	New South Wales
National Practice Area:	Commercial and Corporations
Sub-area:	Commercial Contracts, Banking, Finance and Insurance
Number of paragraphs:	665
Date of hearing:	3-4, 6, 11-14, 21 April 2023
Counsel for the Applicants:	Dr A Greinke with Mr S Lamb
Solicitor for the Applicants:	Lodhia Lawyers
Counsel for the Respondents:	Mr D Moujalli with Mr N Olson
Solicitor for the Respondents:	HWL Ebsworth Lawyers

## ORDERS

NSD 395 of 2020

**BETWEEN:**                    **GIRCHOW ENTERPRISES PTY LTD**

First Applicant

**KARIM GIRGIS**

Second Applicant

**SHERIF GIRGIS** (and others named in the Schedule)

Third Applicant

**AND:**                         **ULTIMATE FRANCHISING GROUP PTY LTD**

First Respondent

**MAZEN HAGEMRAD**

Second Respondent

**SAMER HUSSEINI** (and another named in the Schedule)

Third Respondent

**ORDER MADE BY:**   **THAWLEY J**

**DATE OF ORDER:**   **5 MAY 2023**

### THE COURT ORDERS THAT:

1.     The parties confer with a view to agreeing by 4.00pm on 11 May 2023 orders:
  - (a)     giving effect to these reasons; and
  - (b)     with respect to costs.
2.     The proceedings be listed at 9.00am on 12 May 2023 for resolution of any dispute as to appropriate orders.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

## REASONS FOR JUDGMENT

**THAWLEY J:**

### INTRODUCTION

- 1 This proceeding concerns three Ultimate Fighting Championship Gym franchises, owned and operated by three unrelated companies. The franchises are referred to as the “Balcatta Franchise”, the “Blacktown Franchise” and the “Castle Hill Franchise”.
- 2 The first respondent, Ultimate Franchising Group Pty Ltd (**UFG**), is the Australian franchisor of the UFC Gym franchise, operating under a “Master Territory Agreement” with the Master Franchisor in the United States of America (**USA**), UG Franchise Operations LLC.
- 3 The franchisees and the relevant individuals behind them are as follows:
- Balcatta Franchise: **Girchow** Enterprises Pty Ltd, the first applicant. Its director is the second applicant, Mr Karim Girgis. Interests in Girchow are also held by Mr Sherif Girgis and Mr Paul Chau, the third and fourth applicants. Mr K Girgis and Mr S Girgis are brothers. Each of the three individuals gave a guarantee to UFG guaranteeing the obligations of the Balcatta Franchisee under the Balcatta franchising agreement.
  - Blacktown Franchise: **Activ** Health Clubs Pty Ltd, the fifth applicant. Its director is the sixth applicant, Mr Richard Kim. The shareholders in Activ were Mr Kim and Mr Thi Ahn Tuyet Le, the sixth and seventh applicants. Mr Kim and Mr Le each gave a guarantee to UFG guaranteeing the obligations of the Blacktown Franchisee. Mr Le was removed as a party to the proceeding by a consent order made on 11 March 2021.
  - Castle Hill Franchise: Advanced Club Management Pty Ltd (**ACM**), the eighth applicant. Its sole director and shareholder is the ninth applicant, Mr Laziz Mirdjonov. Mr Mirdjonov gave a guarantee to UFG guaranteeing the obligations of the Castle Hill Franchisee under the Castle Hill franchising agreement.
- 4 The second and third respondents are Mr Mazen (Maz) Hagemrad and Mr Samer (Sam) Husseini, the directors of UFG at all relevant times.

- 5 The applicants claim that they were induced to enter into the franchise agreements and guarantees by conduct which was misleading or deceptive within the meaning of s 18 of the *Australian Consumer Law (ACL)*, being Sch 2 of the *Competition and Consumer Act 2010 (Cth) (CCA)*. The majority of the conduct complained of is constituted by representations alleged to have been made by UFG through Mr Hagemrad.
- 6 After opening the respective franchises, the franchisees discussed with each other their respective experiences. These proceedings were commenced after the applicants raised their concerns with UFG, Mr Hagemrad and Mr Hussein. Although there is only one set of proceedings, as a matter of substance there are three distinct cases.
- 7 The parties agreed that the pleadings gave rise to 20 issues, covering four topics:
- (a) Liability: Issues 1 to 7;
  - (b) Loss, damage and relief: Issues 8 to 13;
  - (c) MSA fees: Issues 14 to 17;
  - (d) Cross-Claim: Issues 18 to 20.
- 8 The applicants' claim relating to MSA fees was abandoned in closing submissions. The cross-claim issues only arise if the applicants are unsuccessful in having the franchise agreements set aside.
- 9 For the reasons which follow, each of the franchise agreements and guarantees should be set aside and each corporate applicant is entitled to damages under s 236 of the ACL for losses sustained because of the respondents' contravention of s 18 of the ACL. Issues 14 to 20 therefore do not arise. The structure of these reasons is:
- first, to set out briefly the central legal principles relevant to liability;
  - secondly, to say something about the central witnesses;
  - thirdly, to make some brief comments about the affidavit evidence;
  - fourthly, to address liability in relation to each franchise, namely Issues 1 to 7;
  - finally, to address loss, damage and relief, namely Issues 8 to 13.

## RELEVANT PRINCIPLES

- 10 Section 18(1) of the ACL provides:



**18 Misleading or deceptive conduct**

- (1) A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

11 Section 236(1) of the ACL provides:

**236 Actions for damages**

- (1) If:
- (a) a person (the *claimant*) suffers loss or damage because of the conduct of another person; and
  - (b) the conduct contravened a provision of Chapter 2 or 3;
- the claimant may recover the amount of the loss or damage by action against that other person, or against any person involved in the contravention.

12 In order to determine whether s 18 has been contravened it is necessary first to identify what constitutes the alleged infringing conduct: *Campbell v Backoffice Investments Pty Ltd* [2009] HCA 25; 238 CLR 304 at [32]. Section 18 focusses on “conduct” not representations as such. The two are not co-extensive: *Butcher v Lachlan Elder Realty Pty Ltd* [2004] HCA 60; 218 CLR 592 at [102]-[103]; *Campbell* at [102]. Where the contravening conduct involves representations, it is necessary to determine whether the representations were conveyed by the conduct as a whole, assessed in context. It is not sufficient to focus solely on particular conversations or parts of conversations, or particular documents or parts of documents, or particular written communications in a series of communications. A line in a document, or a statement during a conversation, must be assessed in the context of the whole document or conversation, and in the context of all of the events, including what was done and not done and what was said or not said: *Butcher* at [39], [109].

13 In a case like the present, where the applicants claim that they entered into agreements and gave guarantees because they were misled by various misrepresentations, it is necessary to examine everything that the respondents did and did not do up to the point in time that the franchise agreements and guarantees were entered into. As McHugh J stated in *Butcher* at [109], “[t]he effect of any relevant statements or actions or any silence or inaction occurring in the context of a single course of conduct must be deduced from the whole of course of conduct”. Something which was misleading when stated early during the relevant events might be corrected by later conduct or cease to have any causative effect.

14 The main representations relied upon as constituting conduct which contravened s 18 were representations with respect to future matters. In this regard, s 4 of the ACL provides:

#### **4 Misleading representations with respect to future matters**

- (1) If:
- (a) a person makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act); and
  - (b) the person does not have reasonable grounds for making the representation;
- the representation is taken, for the purposes of this Schedule, to be misleading.
- (2) For the purposes of applying subsection (1) in relation to a proceeding concerning a representation made with respect to a future matter by:
- (a) a party to the proceeding; or
  - (b) any other person;
- the party or other person is taken not to have had reasonable grounds for making the representation, unless evidence is adduced to the contrary.
- (3) To avoid doubt, subsection (2) does not:
- (a) have the effect that, merely because such evidence to the contrary is adduced, the person who made the representation is taken to have had reasonable grounds for making the representation; or
  - (b) have the effect of placing on any person an onus of proving that the person who made the representation had reasonable grounds for making the representation.
- (4) Subsection (1) does not limit by implication the meaning of a reference in this Schedule to:
- (a) a misleading representation; or
  - (b) a representation that is misleading in a material particular; or
  - (c) conduct that is misleading or is likely or liable to mislead;
- and, in particular, does not imply that a representation that a person makes with respect to any future matter is not misleading merely because the person has reasonable grounds for making the representation.

15 The critical elements of the operation of s 4 to the present case may be stated as follows:

- a representation about a future matter will be deemed to be misleading or deceptive unless the respondent had reasonable grounds to make the representation;
- the respondent will be deemed not to have had reasonable grounds for making the representation unless the respondent adduces “evidence to the contrary”;
- if the respondent does adduce “evidence to the contrary”, then the applicant bears the legal onus of establishing that the respondent did not have reasonable grounds for making the representation.

16 Section 4 of the ACL focusses attention on whether a person in fact *had* reasonable grounds for making a representation with respect to a future matter, not simply on whether there *were* reasonable grounds for making a representation. One way of articulating one of the intended effects of s 4 is to say that it “require[s] the representor to identify the facts or circumstances (if any) actually relied upon before turning it over to the trier of fact to decide whether they were objectively reasonable and whether they support the representation made” – see: *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [2827(c)] (Jagot J), adopting the language of Mason P in *City of Botany Bay Council v Jazabas Pty Ltd* [2001] NSWCA 94; ATPR 46-210 at [85] (albeit concerning different statutory provisions); see also: *Australian Competition and Consumer Commission v Woolworths Ltd* [2019] FCA 1039 at [117] – [131] (Mortimer J) (not relevantly affected on appeal).

17 The applicants referred to *Sykes v Reserve Bank of Australia* (1998) 88 FCR 511 at 513, also referred to by Mason P in *Jazabas*, and Mortimer J in *Woolworths*, in which Heerey J stated:

If there was a representation as to a future matter, s 51A [of the *Trade Practices Act 1974* (Cth)] requires the representor to show:

- some facts or circumstances
- existing at the time of the representation
- on which the representor in fact relied
- which are objectively reasonable and
- which support the representation made.

18 The deeming in s 4(2) is only avoided by adducing “evidence to the contrary”; the evidentiary burden created by s 4(2) is not discharged simply by putting forward some evidence relevant to the topic: *McGrath v Australian Naturalcare Products Pty Ltd* [2008] FCAFC 2; 165 FCR 230 at [191] (Allsop J). The deeming in s 4(2) cannot be avoided, for example, merely by adducing some evidence which is relevant to the objective existence of reasonable grounds.

19 It is for the Court to evaluate whether the evidence adduced is sufficient to constitute “evidence to the contrary”: *McGrath* at [192]. Whether evidence adduced on the topic is sufficient to constitute “evidence to the contrary” should be evaluated having regard to the evident statutory object of requiring the party or person making the representation to adduce evidence of the actual grounds that the person had for making the representation.

20 Section 139B of the CCA provides for the attribution to the company of states of mind and conduct of directors, employees or agents of the company.

## **THE WITNESSES**

### **The UFG witnesses**

#### ***Mr Hagemrad***

- 21 Mr Hagemrad was a director of UFG from 22 June 2016 until 10 December 2018. He has a Masters of Business Administration (Exec) from the University of New South Wales, a Bachelor of Applied Science (Physiotherapy) from the University of Sydney and a Masters of Science (Sports Physiotherapy) from the University of Sydney.
- 22 Mr Hagemrad approached the UFC Gym Master Franchisor in 2013 enquiring about the UFC Gym brand's future international expansion. Over the next two and a half years he negotiated for the right to use the UFC Gym brand in Australia. During that time, he approached Mr Hussein who he had known for over 20 years and Mr Jim Dimas whom he had known professionally for almost 15 years.
- 23 In about July 2015, Mr Hagemrad and Mr Hussein travelled to the US for the final stages of the negotiations with the UFC Gym Master Franchisor. On 21 July 2015, UFG was registered and in September 2015 the Master Territory Agreement was signed.
- 24 I did not find Mr Hagemrad to be a reliable or credible witness. He could not recall a number of events which occurred. Where he could recall events, his recollection was often poor. His evidence was often in the form of argument. His evidence and credibility is discussed further below.

#### ***Mr Samer Hussein***

- 25 Mr Hussein was not as deeply involved in the relevant events as Mr Hagemrad. He readily conceded that his recollection of events in which he was involved was not good. Mr Hussein was cross-examined only briefly.

#### ***Mr Jason Laurence***

- 26 Through his business, 2020 Business Consultancy, Mr Laurence was an independent contractor working for UFG as franchise operations manager until August 2020. He appears to have first met Mr Hagemrad in person on 22 February 2016: Exhibit 20. Mr Hagemrad signed a consultancy agreement between UFG and 2020 Business Consultancy on 20 May 2016. It is not clear when Mr Laurence executed the agreement. The consultancy agreement stated that

it was to commence on 1 July 2016 or a later date to be agreed between the parties. Mr Laurence's evidence was that he commenced in October 2016.

27 Mr Laurence gave oral evidence in chief about his 20 year career in the fitness industry. T438: Mr Laurence was employed in various roles by **Healthland** Fitness International, **Fitness First** Australia and **Goodlife** Health Clubs Australia between 1999 and 2006. He was employed by Healthland as a sales consultant, then a sales manager at the Bondi Junction club and then as a cluster manager where he oversaw the operations of 3 clubs in Queensland. The Healthland clubs ranged from 2000 to 4000 square metres in size. He was employed by Fitness First as regional manager overseeing the operations of 11 gyms in Queensland which ranged from 1400 to 3500 square metres in size. Mr Laurence was employed by Goodlife as its national sales and marketing manager. He was involved in the operations of 37 gyms which ranged from 1000 to 10,000 square metres in size. He was involved in acquiring equipment and establishing clubs, including during a "pre-sale" phase before opening.

28 In 2006 Mr Laurence founded his own consultancy practice "2020 Business Consultancy", which became his full time focus in 2008. Mr Laurence's consultancy involved working with health club owners and national fitness chain clients. Mr Laurence has been engaged by nine "full-time" clients with over 20 gym facilities ranging from 500 to 6000 square metres and up to 6000 members.

29 Mr Laurence gave his evidence in a straightforward way without any obvious exaggeration.

### **Balcatta Franchise**

#### ***Mr Karim Girgis***

30 By the time of the relevant events in 2016, Mr K Girgis had experience in sales, exercise rehabilitation, property investment, share trading and businesses which included gym businesses. In 2012, Mr K Girgis opened a Jetts 24 Hour Fitness franchise with Mr S Girgis in Cannington, a suburb in Perth. The relevant franchise agreement was signed in 2011. A fit-out of premises was required but this was arranged by the franchisor, albeit Mr K Girgis had some limited involvement. Mr K Girgis resigned as a director in February 2014. Mr S Girgis continued as a director and the Jetts business was shut down in 2020.

31 Later, Mr K Girgis opened three F45 Functional Training studios, initially under licence, but later converted to franchises: T86.28. These were in the Perth suburbs of Claremont, Duncraig and Applecross. The Claremont studio opened in October 2014 and was owned by Mr K Girgis

alone. It needed minor fit-out work and the purchase of some equipment. The studio in Duncraig was previously a gym and did not require much fit-out: T63.25. This was owned with Mr Chau and opened in October 2015, as was the studio in Applecross, which also required minor fit-out: T64.4.

32 Mr K Girgis agreed that each of these businesses grew and that he could see what kind of factors influenced growth, including management of the business, competition within the vicinity of the business and marketing or promotional activities: T64. His evidence explained some of the differences between the F45 gym concept and the Jetts gym concept.

33 I found Mr K Girgis to be a credible witness. He gave concessions readily when appropriate. He was careful to give accurate evidence. His evidence was given in a straightforward manner, without exaggeration.

#### ***Mr Sherif Girgis***

34 Mr S Girgis obtained a Bachelor of Commerce from Curtin University. He was a trainee valuer with CBRE from February 2005 until December 2007. He was a pub owner from March 2008 to August 2012. He was a café owner and operator from December 2010 to December 2014.

35 As mentioned, Mr S Girgis held an interest with his brother, Mr K Girgis in the Jetts 24 Hour Fitness franchise in Cannington from about 2011. Mr S Girgis was not initially involved in the operations of the Jetts gym, although he signed a franchise agreement. Mr S Girgis was not involved much in the fit-out of the premises. Mr S Girgis became involved in the operation of the Jetts business when Mr K Girgis moved on to be involved in other businesses. The Jetts business was shut down “during Covid”.

36 I found Mr S Girgis to be generally credible.

#### ***Mr Paul Chau***

37 Mr Chau described his background in a letter attached to an email sent on 9 June 2016. The letter included:

... I have completed a Bachelor of Economics degree, majoring in finance banking, and international business at the University of Western Australia ... Apart from banking specific training I have taken my education further and completed my MBA with the Graduate School of Management at the University of WA.

I was previously employed with the National Australia Bank for the past six years and from these roles, and my education, I have gained valuable experience in the corporate and business banking sectors. Duties that I have undertaken include sales and cross

selling, building customer relationships, financial and credit analysis, and understanding all aspects of a business banking team.

Since 2009 I decided to utilise the skills that I have acquired through my education and employment in the finance sector and move into business for myself in a field which I am passionate about. It was at that time that I saw a unique opportunity with the Jetts Fitness Franchise which offers a 24hr, no contracts gym facility and recognised that it was the next big thing in the fitness industry. I opened my first Jetts in 2010 and to date have opened 5 more all of which have been highly profitable. More recently I recognised the market was again shifting to functional training and decided to move into that niche by joining the F45 Training franchise. In 2015 I opened two F 45 studios with my business partner and they are performing as forecasted. I believe that building successful and highly profitable business's has been due to my ability to identify niches in the industry before the high growth phase before profits are normalised through entry by competition and from there strategically growing the business to ensure the brand is well established as the number one player in the market before our competitors do. I also pride myself on running a business and making sure we are the best at what we do ...

38 Also attached to the 9 June 2016 email was a curriculum vitae which showed that Mr Chau completed a Bachelor of Economics, majoring in finance, banking and international business in 2002. He completed a Masters of Business Administration in 2008. His experience included working as a gym assistant from March 2008 to June 2010, where his responsibilities included day to day operations, managing memberships and marketing and accounting.

39 Mr Chau worked for the National Australia Bank Ltd (**NAB**) from 2001 to 2008. He started as a Customer Service Officer and later held positions as a Business Banking Assistant and an Analyst. His position as an Analyst involved analysing financial information and credit submissions, devising strategies on high risk lends and building relationships with clients. From April 2006 to February 2008, Mr Chau held the position of Senior Business Banker & Relieving Manager. His responsibilities included analysing financial information, preparing credit submissions and managing portfolios up to \$60 million, that is, lending to clients amounts of up to \$60 million each: T237. He agreed that he was accustomed to dealing with loan agreements, mortgage and other security documents and guarantees: T237.

40 Mr Chau gave evidence in cross-examination that he signed a franchise agreement in relation to the Jetts gym he opened in 2010: T238. He was the sole owner of the business. He was involved in the operation of the business at times: T238.37.

41 He then opened another five Jetts 24 Hour Fitness franchises: T239. At the time of the relevant events in 2016, Mr Chau had opened six Jetts businesses in the Perth suburbs of Forrestfield, Morley, Innaloo, Dianella, Yokine and Bassendean. Each facility ranged from 300 to 400 square metres in size: T244. Each of them had a membership in excess of 1000 at some point

in time between when the relevant business opened and 2016: T244. Mr Chau signed franchise agreements in relation to each of those businesses. Each of the businesses except Bassendean was run by a corporate entity of which Mr Chau was a director: T243. He signed the financial statements for at least some of the businesses. These financial statements indicated the expenses incurred in the start-up phases of the businesses: T244.

42 Mr Chau thought he had ceased his involvement with each of them, with the possible exception of Innaloo, by mid 2016, but could not be sure: T245. He ceased his involvement by selling his shares to his business partners or back to the franchisor: T240.

43 Consistently with Mr K Girgis's evidence, Mr Chau stated that he opened two F45 studios in 2015 with Mr K Girgis: T246. They were in Applecross and Duncraig, in Perth. Both were about 150 square metres in size. Both were operated through a corporate vehicle of which Mr Chau was a director. Mr Chau signed the financial statements. The membership of each was possibly around 200 to 300. Mr Chau continued to hold an interest in these gyms in 2016: T247.

44 In 2016, Mr Chau, Mr S Girgis and Mr K Girgis sent a Draft Business Plan to UFG. Mr Chau was cross-examined in relation to the comment made in it that he had "vast" experience in the fitness industry. He gave the following evidence at T248:

From your involvement with those gyms, you were able to observe what factors could affect the size of a membership at the start of the business; correct?---Correct.

I should also ask this, Mr Chau: in addition to being a director of the companies which ran these gyms, you were also a shareholder; correct?---Yes, correct.

You were able to observe how the size of the membership of the gym grew over the first 12 months of operation; correct?---Correct.

You were able to observe how things such as marketing or promotional activities could affect the growth of the membership; correct?---Correct.

You were able to observe any patterns with the cancellation of membership over time?---Correct.

45 I considered Mr Chau to be credible and his evidence to be generally reliable.

## **Blacktown Franchise**

### ***Mr Richard Kim***

46 Mr Kim is a physiotherapist by profession. From about 2012, Mr Kim owned and operated "a multi-location allied health company", which operated from 8 locations, employed 20 staff and



generated between \$1.5 and \$2 million per year. The business was run through a corporate entity of which he was a director and a shareholder.

47 Mr Kim was an impressive witness. He answered each question directly and honestly without any tendency to distort an answer in his own interest. I accept his evidence without reservation.

### **Castle Hill Franchise**

#### ***Mr Laziz Mirjdonov***

48 Mr Mirdjonov has two bachelor degrees. One was described as “Management in Information Technologies” obtained in Australia in 2006. The other is a degree in law, obtained in Russia in 1999. He practised criminal law in Uzbekistan for about a year after he completed his degree: T312, 356.

49 Mr Mirdjonov was the sole owner of a gym business founded in 2015, Spectrum Fitness Australia. The business was held by a corporate entity of which Mr Mirdjonov was the director and sole shareholder. It was not a franchise. The premises needed to be fitted-out which involved building work being carried out and equipment being acquired. It was about 350 square metres in size with a membership of around 300.

50 The reliability of Mr Mirdjonov’s evidence varied, although I generally preferred his recollection of events over Mr Hagemrad’s recollection.

### **THE EVIDENCE**

51 The witness evidence was largely given by affidavit. There are two aspect of the affidavit evidence which warrant mention.

52 First, the affidavits contained numerous accounts of conversations, often in direct speech. It is fair to say that attention was not given to the sorts of considerations recently emphasised by Jackman J in *Kane’s Hire Pty Ltd v Anderson Aviation Australia Pty Ltd* [2023] FCA 381 at [123] to [129]. Further, some of the accounts of conversations contained in the affidavits may have been affected by the matter referred to next.

53 The applicants’ affidavit evidence on reliance was criticised by the respondents as being “rudimentary, formulaic and given by each of them in identical, or almost identical, terms”. It is the reliance on affidavit evidence in identical or almost identical terms which is the second matter which warrants mention.

54 Mr K Girgis's first affidavit dated 29 September 2020 contained the following (text in strikethrough was not read):

- 22 ... I read the disclosure document in particular, and I noted:
- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein regarding the UFC Gym franchise operations at item 3.1; and
  - (b) the establishment costs at Table 1 of Schedule 5.
- ...
- 32 In deciding to enter into the Balcatta franchise agreement and agreeing to be a guarantor, I relied on:
- (a) the cashflow forecasts regarding the future income of the franchise; and
  - (b) the forecast start-up and fit-out costs provided by Maz Hagemrad and Sam Hussein, as set out above in this affidavit.
- 33 Had I known the actual startup costs would be ~~much~~ larger than the forecasts (~~as they were in fact~~), or the income project[ion]s would not be realised, I would not have agreed to the Balcatta Franchisee becoming a franchisee, and I would not have agreed to be a guarantor of the franchise business.

55 Mr S Girgis's first affidavit dated 29 September 2020 contained the following:

- 12 At the time I read this disclosure document in particular, and I read about:
- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein regarding the UFC Gym franchise operations at item 3.1; and
  - (b) the establishment costs at Table 1 of Schedule 5.
- ...
- 21 In deciding to enter into the Balcatta franchise agreement and agreeing to be a guarantor, I relied on:
- (a) the cashflow forecasts regarding the future income of the franchise ; and
  - (b) the forecast start-up and fit-out costs provided by Maz Hagemrad and Sam Hussein, as set out above in this affidavit.
- 22 Had I known that the actual income would not grow as projected, or had I known the actual startup costs would be ~~much~~ larger than the forecasts (~~as they were in fact~~), or that the income project[ion]s were unreliable, I would not have agreed to the Balcatta Franchisee becoming a franchisee, and I would not have agreed to be a guarantor of the franchise business.

56 Mr Chau's first affidavit dated 29 September 2020 contained the following:

- 28 At the time I read the disclosure document in particular, and in particular I read about:
- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein

regarding the UFC Gym franchise operations at item 3.1; and

- (b) the establishment costs for the gym (Table 1 of Schedule 5).

...

36 In deciding to enter into the Balcatta franchise agreement and agreeing to be a guarantor of that franchise, I relied on:

- (a) the cashflow forecasts regarding the future income of the franchise; and
- (b) the forecast start-up and fit-out costs provided by Maz Hagemrad and Sam Hussein, as set out above in this affidavit.

37 Had I known the actual startup costs would be ~~much~~ larger than the forecasts ~~(as they were in fact)~~, or that the income would not be as represented, I would not have agreed to the Balcatta Franchisee becoming a franchisee, and I would not have agreed to be a guarantor of the franchise business.

57 Mr K Girgis – who was the first witness to give evidence – was cross-examined extensively on the similarities between the affidavit.

58 The thrust of the cross-examination was that Mr K Girgis, Mr S Girgis and Mr Chau had discussed their evidence and affidavits and the similarities were not purely coincidental. Mr K Girgis was challenged on other similarities in the affidavit evidence, including similarities in some accounts of conversations. Again, the thrust of the cross-examination was that he had discussed his evidence with Mr Chau and Mr S Girgis.

59 It was not put to Mr K Girgis that he discussed his evidence with Mr Kim or Mr Mirdjonov. Mr Kim's affidavit contained the following:

22 I read the disclosure document and in particular I relied on:

- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein regarding the UFC Gym franchise operations at item 3.1; and
- (b) the establishment costs at Table 1 of Schedule 5.

...

25 In deciding to enter into the Blacktown franchise agreement and agreeing to be a guarantor, I relied on:

- (a) the cashflow forecasts regarding the future income of the franchise; and
- (b) the forecast start-up and fit-out costs provided by Maz Hagemrad and the disclosure document, as set out above.

26 Had I known the actual startup costs would be ~~much~~ larger than the forecasts ~~(as they were in fact)~~, or the income project[ion]s would not be realised, I would not have agreed to the Blacktown Franchisee becoming a franchisee, and I would not have agreed to be a guarantor of the franchise business.

60 Mr Mirdjonov's affidavit contained the following:

17 I read the disclosure document in particular, and from that document, what important to me was:

- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein regarding the UFC Gym franchise operations at item 3.1; and
- (b) the startup costs at Table 1 of Schedule 5.

...

21 In deciding to enter into the Castle Hill franchise agreement and agreeing to be a guarantor, I relied on:

- (a) the cashflow forecasts regarding the future income of the franchise; and
- (b) the forecast start-up and fit-out costs as set out above in this affidavit.

22 Had I known the actual startup costs would be ~~much~~ larger than the forecasts or that the income project[ion]s would not be realised, I would not have agreed to the Castle Hill Franchisee becoming a franchisee, and I would not have agreed to be a guarantor of the franchise business. ...

61 The reason the affidavits are all similar in the respects identified is because of the way in which the affidavits were prepared. I infer that the passages extracted above were "cut" and "pasted" between affidavits, before being altered in minor ways. The inference is compelling for many reasons, including the misspelling of the word "projects" rather than "projections". These were not the only passages which appear to have been prepared in that way.

62 The consequence of what has occurred is that the affidavit evidence about reliance is called into question. It seems unlikely, for example, that each of the witnesses independently instructed that they read the relevant disclosure document and, when reading it, they each particularly noted: (a) the explanations of the experience of Mr Hagemrad and Mr Hussein in cl 3.1; and (b) Table 1 of Schedule 5, but apparently not Tables 2 and 3.

63 A further consequence of what has occurred is that witnesses were exposed to an attack on credibility which might have found favour if what had occurred was not so obvious, particularly once regard was had to the affidavits in the Blacktown and Castle Hill cases.

64 The drafting of affidavits in this way has a number of other negative consequences, including making it more difficult, and sometimes impossible, to give serious weight to the evidence. When the evidence is on a topic which must necessarily be established, such as reliance, the consequences could be fatal to the case being advanced.

65 Further, an affidavit must reflect a witness's evidence, not the evidence which the legal practitioner would prefer to see in light of the case which the legal practitioner has pleaded or wishes to run. A legal practitioner must not suggest to a witness what the witness's evidence should be. The placing of material in an affidavit which is not based on what the witness has instructed and is taken from a different witness's affidavit – such as an account of events or a statement about what a person relied upon – amounts, in substance, to a suggestion about what the witness should say.

66 Where it appears that parts of affidavits have been copied from other affidavits, doubt is cast on the integrity of the whole process by which the affidavits have been prepared. This inevitably affects the assessment of the reliability of the whole affidavit. The problem is particularly acute where evidence of conversations appears to have been drafted in this way. It suggests a lack of attention on the part of the drafter of the affidavit to accurately recording the deponent's actual recollection of what was said, or the gist of what was said, and risks causing a deponent to swear or affirm the truth of something outside his or her knowledge.

67 Similar issues were raised by Derrington J in *Tour Squad Pty Ltd v Fifth Amendment Entertainment Inc (No 2)* [2021] FCA 546; 151 ACSR 607 at [127]. The issue is important. The preparation of unambiguous, accurate and truthful affidavits is central to the fact finding process. The drafting of affidavits by a process of copying other witnesses' affidavits might save time for the drafter of the affidavit at the time, but it results in increased risk to the witness and client, increased cost and delay overall and, potentially, professional conduct issues. It certainly impedes the efficient and effective determination of disputes by the Court.

68 It is in part to take proper account of the two matters raised in this section of these reasons that I have set out below lengthy extracts from the affidavits, together with the contemporaneous documents.

## **LIABILITY: BALCATT A FRANCHISE**

### **Factual Background**

69 After the Master Territory Agreement was signed, UFG set up a website and invited anyone who might be interested in learning about becoming a franchise owner of a UFC Gym in Australia to register.

70 On 7 January 2016, Mr Hagemrad arranged for invitations for a presentation to be held at Hyatt Regency Hotel in Perth on 19 January 2016 to be sent by email to all those who had registered on the website.

***19 January 2016: Hyatt presentation***

71 The Hyatt presentation proceeded on 19 January 2016. Mr K Girgis, Mr S Girgis and Mr Chau attended. Mr Hagemrad and Mr Hussein were present. At the time, no UFC Gyms were operating in Australia. The formal part of the presentation was given by Mr Hagemrad by reference to PowerPoint slides which he prepared from slides given to him by the UFC Gym Master Franchisor. He edited some of the slides to reflect the Australian market as he knew it at that time.

72 Slide 66 was headed “The Franchise Offering”:

**THE FRANCHISE OFFERING**

**TOTAL INITIAL INVESTMENT :** \$390,000 - \$550,000

**WORKING CAPITAL:** EQUAL TO 3 MONTHS

**FRANCHISE FEE:** \$60,000 PER FRANCHISE  
(Includes Training for all Franchisees Listed on Franchise Agreement)

**FRANCHISEE TRAINING:** 5 DAYS AT UFC GYM HQ (OC, SANTA ANA, CALIFORNIA)

**UFC HQ VISIT:** PERSONLISED VISIT TO UFC HQ IN LAS VEGAS TO MEET EXECUTIVE TEAM

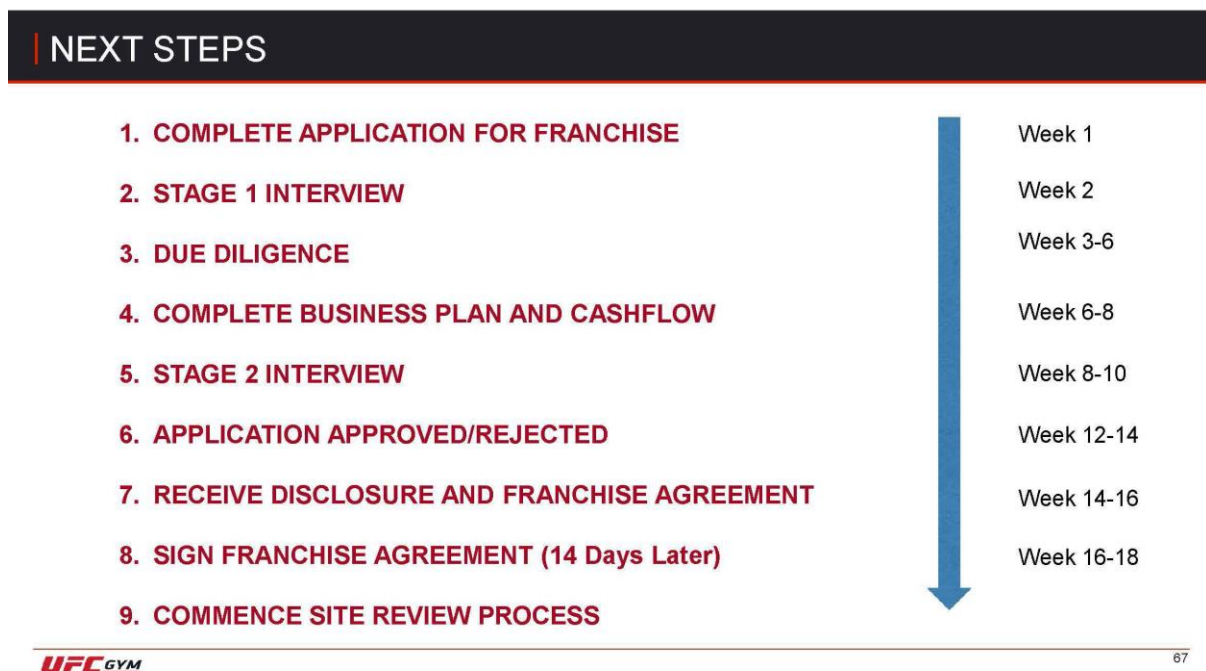
**ROYALTY:** 10% OF NET SALES

**MARKETING FUND:** 2% OF NET SALES

**UFC GYM**

66

73 Slide 67 was entitled “Next Steps” and set out a time line for the various stages of an application:



74 Mr K Girgis gave evidence that the presentation was given mostly by Mr Hagemrad, with Mr Hussein occasionally commenting. He stated that there was a question and answers session after the presentation. Mr K Girgis’s first affidavit included:

- 10 During the presentation Maz [Hagemrad] said words to the effect that:
- (a) franchises for UFC Gym would be able to be established for startup costs in the range of \$500,000 to \$800,000;
  - (b) the projected figures of \$500,000 to \$800,000 would be inclusive of all equipment and fit-out costs, franchise fees, training and working capital.

75 Mr S Girgis’s first affidavit included:

- 7 During the presentation Maz said words to the effect:
- (a) franchises for UFC Gym would be able to be established for startup costs in the range of \$500 ,000 to \$800,000;
  - (b) the estimate of \$500,000 to \$800,000 was inclusive of all equipment and fitout costs, with the fitout being about \$250,000 to \$300,000 and \$200,000 to \$250,000 depending on the fitout costs.
- 8 In answer to questions from Karim [Girgis], Maz said words to the effect:
- (a) they would need to check with US head office as to the brand of equipment;

- (b) the weekly membership cost was \$30 per week;
- (c) the maximum space was about 1000 square metres;
- (d) there would be about 8 to 12 personal trainers and coaches.

76 Mr Hagemrad denied making a representation as set out in [10(a)] of Mr K Girgis's affidavit and [7(a)] of Mr S Girgis's affidavit.

77 Mr K Girgis's first affidavit also included:

11 In the question and answer session, I asked the following questions, which were answered by Maz or Sam [Husseini]:

Karim: How much is the fitout expense?

Maz: About \$250,000 to \$300,000 depending on club size.

Karim: What about the equipment costs?

Maz: About \$200,000 to \$250,000.

Karim: What brand of equipment will be used, because this seems relatively cheap compared to my previous experience with Jetts Fitness?

Sam: Ahh, not 100% sure. We will confirm that with the US head office.

Karim: The total startup costs of opening a Jetts club of around 300 square metres is about \$500,000, so the costs seems a bit low to me. Do you think this is accurate?

Maz: Considering the size variance of 800 square metres to 1200 square metres, the franchise fee and working capital, a club over 1000 square metres would be most likely to be anywhere from \$500,000 to \$800,000.

Karim: What is the weekly membership cost?

Maz: About \$30 per week.

Karim: What is the maximum number of members a club can have?

Maz: We generally go by 1 member per 1 square metre of space, so 1000 square metres is 1000 members.

Karim: How many staff are required? And the wage expense?

Maz: Full-timers are 1 General Manager, 2 sales, 1 reception manager and another 3 or 4 casual receptionists.

Karim: How many trainers are required? PT's and MMA coaches?

Maz: 8 to 12 total.

78 Mr Chau's first affidavit stated the following about the meeting:

7 The presenters at the Hyatt on behalf of the franchisor were Maz Hagemrad and Sam Husseini. The presentations included slides. Afterwards there were



questions and answers, during which Karim asked some questions answered by Maz and Sam. I did not ask any questions of relevance.

- 8 Karim asked Maz and Sam questions about:
- (a) the size of the gym and number of members - we were told it depends, but the ideal size is about 1 member for 1 sqm;
  - (b) the costs of the fitout - about \$250,000 to \$300,000
  - (c) the cost of the equipment - about \$200,000 to \$250,000
  - (d) the brand of the equipment - they did not know the answer to this question;
  - (e) numbers of staff; and
  - (f) membership charges - \$30 / week.
- 9 During the presentation Maz Hagemrad said that the investment would be \$390,000 to \$550,000 plus 3 months working capital and a \$60,000 franchise fee, plus the costs of training in the United States.
- 10 In the questions afterwards, Karim asked Maz further about costs. Maz said that there was a variance in costs for clubs between 800 to 1200 sqm, and with a franchise fee and working capital, a club over 1000 sqm would be likely to be between \$500,000 to \$800,00[0]. He said that this figure included equipment and fit-out costs.

79 Mr Hagemrad stated that he could not recall being asked questions by Mr K Girgis, but could recall general discussion by those in the room. He denied stating that the maximum space was 1000 square metres, this being inconsistent with slide 55. He also denied stating that he would need to check with US head office about the brand of equipment, as they had “full autonomy in Australia to select equipment manufacturers”. Mr Hagemrad’s first affidavit included:

- 12 I do not recall being asked a question about costs of the “fit out” or “the equipment” and I deny that I gave the figures referred to in paragraph 8 of the Chau affidavit and paragraph 7 of the Sherif affidavit. The only figures I referred to during the Perth presentation were those set out in my slides. I do not recall being asked any question by Karim Girgis, or anyone else, which referred to a “Jetts club” or any other gymnasium business.

80 Mr Hussein’s first affidavit included:

- 8 I refer to paragraph 8 of the Sherif affidavit and paragraph 11 of the Karim affidavit. Maz made the presentation on his own and I did not speak during it. At the end of the presentation there was a time for questions from the attendees. I joined Maz for the question time. I recall Karim asked a question about the equipment cost and I said words to the effect “the equipment will be on an operating lease but we have not yet selected an equipment supplier.” I deny that I said we need to check with the US head office, as the US head office had nothing to do with which equipment company we chose. This was the only question I recall answering. I deny any question was asked by Karim about “fit out expense”. I do not recall being asked any question by Karim Girgis, which referred to a “Jetts club”, or any other gymnasium business.

81 It was put to Mr Chau in cross-examination that the only thing Mr Hussein said at the Hyatt presentation was: “The equipment will be on an operating lease, but we have not yet selected an equipment supplier”. Mr Chau responded: “No, I don’t – I don’t know. I don’t remember what he said”.

82 In cross-examination, Mr Hussein accepted that UFG had not decided what brand of equipment to use: T563. He accepted that his recollection of the event was not good. He did recall Mr K Girgis asking about equipment costs: T563.4.

83 I do not accept that Mr Hussein said that the equipment would be on an operating lease. There was no contemporaneous document which suggested that, at the time, it was contemplated recommending that equipment should be leased. If Mr Hussein had said what he claimed, the relevant cost would have been discussed and the cost would have been provided for in the cash flows which were prepared in June 2016. The cash flows which were prepared contained no provision for hire purchases or equipment “leases” in the nature of hire purchases.

***10 February 2016: Cash Flow Template***

84 In early February 2016, Mr Chau had a telephone conversation with Mr Hussein in which Mr Hussein said that he wanted to discuss the opportunity with UFG. Mr Chau stated that they – Mr K Girgis, Mr S Girgis and Mr Chau – needed further information in particular regarding the projected cash flow. Mr Hussein stated that he would send a cash flow template.

85 Mr Hussein sent an email to Mr Chau on 10 February 2016 attaching a template for a 12-month cash flow (**Cash Flow Template**). It was an excel worksheet. It contained formulas for the cost of goods sold (50%) and for advertising (2%) and royalties (10%). The template contained excel instructions to add the monthly numbers to provide a yearly total. At the end, it stated:

Assumptions:

1. Gross income is expected to increase by a sustainable 3% each month. This is conservatively applied given the location
2. COGS for merchandise should be approximately 50%.
3. Advertis[i]ng & royalty expenses are fixed to 2% & 10% of the gross income respectively.
4. 9.5% of gross salary & wages are subject to superannuation

86 The Cash Flow Template did not contain amounts for any item of income or expense.

### ***31 March 2016: First Disclosure Document***

- 87 The First Disclosure Document (defined below) was dated 31 March 2016. It was not sent to Mr K Girgis, Mr S Girgis and Mr Chau at this time. It was signed by Mr Hussein, but prepared by Mr Hagemrad. Tables 1 to 3 of Schedule 5 are set out at [159] to [161] below. At this point, it is relevant to note that Table 1 of Schedule 5 of the First Disclosure Document which addressed “Establishment Costs” referred to the “lease or purchase of equipment” in the range \$250,000 to \$350,000 and to “building, construction and fitout costs” in the range “\$190,000 to \$360,000 (approx 300 psm)”. Table 1 also referred to other expenditure as part of “Establishment Costs” including working capital of \$35,000 to \$65,000 and travel expenses for training of between \$20,000 to \$30,000.
- 88 In the First Disclosure Document, Mr Hagemrad referred in cl 3.1 to his significant experience as a Subway franchisee. Clause 4.1 required disclosure of proceedings against a franchisor director if those proceedings involved (amongst other things) an allegation of a contravention of trade practices law or misconduct. One point of such a clause is to enable prospective franchisees to make an informed decision about whether or not the franchisor and its directors and associates are the kinds of people with which the franchisee wishes to have an ongoing commercial relationship of trust and confidence.
- 89 The First Disclosure Document, which Mr Hagemrad prepared, answered “Not Applicable” to cl 4.1.
- 90 In fact, as at 31 March 2016, Mr Hagemrad was a respondent in proceedings in this Court brought by Mr Shah in which Mr Shah alleged that Mr Hagemrad and one Mr Allouche fraudulently inflated the sales figures for a Subway franchise in Haymarket before offering it for sale. The case was run as a s 18 ACL claim but it was “founded on the proposition that Mr Hagemrad and Mr Allouche deliberately and dishonestly created fake sales that were included in sales records upon which they knew prospective purchasers would rely”: *Shah v Hagemrad* [2018] FCA 91 at [2]. Ultimately, Nicholas J rejected as false Mr Hagemrad’s evidence that the Haymarket franchise was profitable: at [94]. His Honour concluded that Mr Hagemrad knew of the fake sales and that those sales were “created” in order falsely to inflate sales figures so that a better price for the Haymarket franchise could be obtained when it came to be sold: at [101].
- 91 Of course, the judgment in those proceedings is not admissible in these proceedings as evidence of the existence of facts in issue in those proceedings.

92 What is important for present purposes is that Mr Hagemrad knew he was required to make a disclosure of the litigation in the First Disclosure Document and, indeed, in each of the disclosure documents given in relation to each of the three franchises the subject of this litigation. He did not. His failure to do so reflects poorly on his credit.

***13 April 2016: Skype meeting***

93 A Skype meeting was held on 13 April 2016 between Mr K Girgis, Mr S Girgis, Mr Chau, Mr Hagemrad and Mr Hussein. In his first affidavit, Mr K Girgis stated:

14 During this Skype meeting Maz said words to the effect:

- (a) a UFC Gym franchise would be able to be established for startup costs in the range of \$500,000 to \$800,000;
- (b) the range of startup costs was based on the size of the premises, with larger premises being at the higher end of the range.

15 We also discussed the application process, including having to provide personal financials and business experience, the variety of classes offered. Staff responsibilities, martial arts coaches, which was forecast as \$50 per hour rates, insurance costs and travel expenses, training in the US.

16 Maz said in particular words to the effect, “Martial arts coaches fees are essentially covered by the PT rent so you don’t really have to pay for martial arts coaches”.

94 Mr S Girgis did not give evidence about this meeting.

95 In his first affidavit, Mr Chau stated:

On 13 April 2016 we had an initial Skype meeting with Karim, Sherif and myself on Skype with Maz Hagemrad and Sam Hussein. During this Skype meeting Maz said again that a UFC Gym franchise would be able to be established for startup costs in the range of \$500,000 to \$800,000. He said that this range of startup costs was based on the size of the gym, with larger gyms being at the higher end of the range.

96 Mr K Girgis and Mr Chau were both cross-examined on the similarities between their affidavits in this respect.

97 In his first affidavit, Mr Hagemrad stated:

During that video conference I agree that I said words to the effect “the start-up costs are likely to be between \$500,000 and \$800,000”. By that time, I had obtained more information about potential set-up costs for a UFC Gym. I also said words to the effect “The setup costs will vary depending on the site size, location and age of the premises, and a range of other variables”. I deny I said words to the effect “Martial arts coaches fees are essentially covered by the PT rent so you don’t really have to pay for Martial arts coaches”. The call was to discuss their franchise application, not detailed specifics about business operations.

98 In cross-examination in relation to the Skype meeting on 13 April 2016, Mr K Girgis stated that he understood Mr Hagemrad to be predicting the actual costs, or making a statement about what the actual costs would be, rather than expressing his existing opinion as to the likely costs. Mr K Girgis confirmed that he had an actual recollection of what was said by Mr Hagemrad in this regard: T131-3.

99 Mr Chau accepted that he could not remember word for word what was said during the Skype meeting: T295.20. His evidence at 295 included:

Was the wording in paragraph 19 of your affidavit provided to you by your lawyers?---I believe they would have, yes, done some – whatever to it.

What Mr Hagemrad said at this conference was words to the effect of that the start-up costs are likely to be between \$500,000 and \$800,000. Do you accept that that is a more correct version of what Mr Hagemrad said?---I do not recall the exact words, so I – I can't say.

Would it be fair to say that you do not specifically recall the words “would be” being used?---That's fair.

100 In cross-examination, Mr Hagemrad stated that he had a recollection of the meeting, but not the specifics: T473.20. He recalled mentioning the amounts of \$500,000 and \$800,000.

101 After the Skype meeting on 13 April 2016, Mr Hagemrad sent an email to Mr Chau, copied to Mr K Girgis and Mr S Girgis, which attached a “New Application Form” and a “Business Plan Template”. The Business Plan Template required the prospective franchisee to insert a variety of information, including information about the proposed management of the business and a “SWOT” analysis.

***16 May 2016: Email from Life Fitness***

102 On 16 May 2016, Mr Aaron Oman, the Commercial Accounts Manager of Life Fitness sent an email to Mr Hagemrad and Mr Dimas. He attached a concept floor plan for a gym of 850 square metres and an “equipment proposal” for the concept. The equipment proposal provided two quotes. The difference in quotes related to whether the “Discover SE” or “Integrity” line of Life Fitness products was chosen. The total cost of Life Fitness and Hammer Strength equipment if the “Integrity” line were chosen was \$269,971.35, including GST of \$24,542.85. The total cost of Life Fitness and Hammer Strength equipment if the “Discover SE” line were chosen was \$315,159.35, including GST of \$28,650.85. Both quotes included a “lease” option over a 48 month term (\$6,440.34 and \$7,470.58 per month respectively).

103 The email included the following at the end:

Lastly and most importantly, we would like to meet and discuss the first NSW site. I have spoken with Paul and we would like to work with you on the initial facility in Western Sydney, as a preferred supplier. Whilst we are unable to provide the products to you at no charge, we are interested in supplying them at our cost, with no margin added.

We feel that the facility is going to be a key site for you and we have no doubt that Life Fitness and Hammer Strength products, will improve your exposure in this region. We already supply a number of large western Sydney facilities and the majority of attendees are familiar with our brand and quality of product.

In addition to the discounted pricing, we would also look to offer you a discounted rate of internal finance, to assist the group in your infancy. By financing with Fitness Equipment Finance, your capital expenditure will not be tied up with equipment, keeping funds free for your initial growth.

I believe you have your eye on a couple of sites at the moment, that may be suitable. If this is the case, we would like to prepare a proposed layout and equipment proposal based on the proposed location.

104 On 18 May 2016, Mr Chau emailed Mr Hagemrad and Mr Hussein stating that he, Mr K Girgis and Mr S Girgis were completing the cash flow.

***9 June 2016: Draft Business Plan and Draft Cash Flow***

105 On 9 June 2016, Mr Chau sent an email to Mr Hagemrad and Mr Hussein attaching a completed **Draft Business Plan**, a completed draft 12-month cash flow worksheet (**Draft Cash Flow**) and resumes and other information about Mr K Girgis, Mr S Girgis and Mr Chau. Mr Chau's email asked the recipients to have a look at the attachments so that they could be discussed before they were submitted.

106 The Draft Business Plan identified the management team as Mr S Girgis, Mr K Girgis and Mr Chau. It attached resumes and other information for each. These are addressed below. It described the roles of the management team in the following way:

Sherif Girgis - Managing Director

Sherif will be the main operator of the business and be the director who will be the business full time.

Amber Chia - Assistant Manager/ trainer

Amber who is Sherif's partner will assist in running the business and is also a qualified trainer

Karim Girgis - Support and Training

Karim is a very experienced trainer and experienced business owner and will provide support to Sherif and Amber

Paul Chau - Financial and business management

Paul has vast experience in the fitness industry as a business owner and also in finance and management and will assist in all aspects of the business including strategy and marketing

In addition to the key stakeholders above we plan on recruiting an experienced General Manager to operate the business.

107 The Draft Business Plan contained a SWOT analysis. The Draft Business Plan contained a section entitled “Strategies” which addressed various matters including goals. One of the goals was achieving breakeven membership numbers within 6 months of operation and “capacity membership” within 12 months of operation.

108 The Draft Cash Flow was prepared primarily by Mr Chau from the Cash Flow Template. It covered the period May 2017 to April 2018. It forecast \$96,000 in gross income per month. This was based on 800 members paying \$30 per week, yielding \$1,152,000 in gross income over the 12 month period. The Draft Cash Flow contained an expense for interest at \$1,458 per month, totalling \$17,496 for the year. The Draft Cash Flow also contained a row for “Hire Purchase Repayments”. This row contained no expense.

109 The Draft Cash Flow was as follows:

<i>12 Month Cash Flow Worksheet</i>													
Receipts	Budgeted Achievable Scenario												
	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	Total
Gross Income <sup>1</sup> (recurring Dues)	96,000	96,000	96,000	96,000	96,000	96,000	96,000	96,000	96,000	96,000	96,000	96,000	1,152,000
Retail (merchandise/F&B)	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	115,200
Total	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	1,267,200
<b>Direct Costs</b>													
Purchases <sup>2</sup>	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	57,600
COGS (50%)	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	57,600
<b>Sales Rec Less Direct Costs</b>	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	1,209,600
Advertising (2%) <sup>3</sup>	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	25,344
Royalty (10%) <sup>3</sup>	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	126,720
<b>Gross Profit</b>	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	1,057,536
<b>Trade Payments</b>													
Accounting & Legal Costs	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Bank & Merchant Charges	1,056	1,056	1,056	1,056	1,056	1,056	1,056	1,056	1,056	1,056	1,056	1,056	12,672
Bookkeeping	135	135	135	135	135	135	135	135	135	135	135	135	1,620
Electricity	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
Gas	-	-	-	-	-	-	-	-	-	-	-	-	-
Insurance	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Interest Expenses	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	1,458	17,496
Office Expenses	300	300	300	300	300	300	300	300	300	300	300	300	3,600
Rent	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	150,000
Repair & Maintenance	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Salaries & Wages	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	240,000
Superannuation <sup>4</sup>	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
Telephone	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Workers' Compensation	100	100	100	100	100	100	100	100	100	100	100	100	1,200

Travel expenses	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Other Payments	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
<b>Total Trade Payments</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>42,949</b>	<b>515,388</b>
Net Operating Cash Receipts	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	542,148
Less Corporate Tax Instalments	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Trade Receipts	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	45,179	542,148
Hire Purchase Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank Loan Repayments Appx	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	34,800
Subtotal	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	507,348
<b>Plus Capital Receipts</b>													
New Loan	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Cash Flow	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	42,279	
Opening Cash Balance	42,279	84,558	126,837	169,116	211,395	253,674	295,953	338,232	380,511	422,790	465,069	507,348	
Closing Cash Balance	42,279	84,558	126,837	169,116	211,395	253,674	295,953	338,232	380,511	422,790	465,069	507,348	

**Assumptions:**

1. Gross income is expected to increase by a sustainable 3% each month. This is conservatively applied given the location
2. COGS for merchandise should be approximately 50%.
3. Advertising & royalty expenses are fixed to 2% & 10% of the gross income respectively.
4. 9.5% of gross salary & wages are subject to superannuation

Income - expected revenue at 80% of capacity with each member paying \$30 a week. No income growth factored in for conservativeness  
retail sales - 10% of revenue  
COGS - 50% of retail sales

Interest expense - 50% borrowing (250k) at 7% interest over 7yrs with principal and interest repayments  
rent - 1000sqm at \$150/sqm gross  
wages - based on f/t GM @80k, f/t fitness director 60k, 2x p/t sales consultants 60k plus bonus

110 Consistently with what is indicated at the end of the Draft Cash Flow, Mr Chau stated that the interest expense was calculated on a borrowing of half of the start-up costs (\$250,000), which was stated in the Draft Cash Flow to total \$500,000: T233. As to “gross income”, he stated at T233:

[W]e got the information that we should, like, work on one person per square metre capacity and it’s always – we were always under the impression that we would be operating a 1000 square metre facility and that the weekly dues would be \$30 a week; that information, we got from Maz. Also speaking to Maz, he recommended that we use an 80 per cent capacity as an achievable, I guess, result within the first 12 months, so I plugged that in, put the formula in, and that’s how we came up with that figure.

111 Mr Chau was cross-examined about [17] of his affidavit, in which he had stated that 80% capacity had come from the Hyatt presentation and later emails. Mr Chau accepted that the information was not contained in any email communication before 9 June 2016: T265.13 He accepted that it was not mentioned as having been something discussed at the Hyatt presentation on 19 January 2016: T265.29.

112 Mr Chau gave evidence that the information came from a conversation between Mr Chau and Mr Hagemrad. His evidence included:

Are you able to identify specifically – are you able to identify more specifically when Mr Hagemrad – when you say Mr Hagemrad said this to you?---It was on a call, but I can’t recall the exact date.



Was anyone else involved in that call?---I don't think so.

You accept that you make no mention of this in your first affidavit. Correct?---Correct.

And do you also accept that you make no mention of it in your second affidavit. Correct?---Correct.

...

The truth of the matter, Mr Chau, is this. You sitting here now, in the witness box, you have no recollection of Mr Hagemrad saying to you anything about 80 per cent capacity or 800 members when you prepared the cashflow document send on 9 June 2016. That's the case, isn't it?---I recall him advising us that that would be an achievable target for the first 12 months. In terms of the cashflow, this is the first time I've received a blank template from all the previous franchises. They've given us a model and I complete it as best I could and then, with their guidance. So yes, he – he did say that.

...

And what I'm putting to you is, sitting here, giving evidence to his Honour, you have no real recollection of Mr Hagemrad having said to you seven years ago anything about 80 per cent capacity or 80 members when you prepared the cashflow document. That's the case, isn't it?---I do remember that. That's where I got the figure from.

113 Mr Hagemrad accepted that he had stated that one could work with one person per square metre at some time between April and June 2016: T502, 503.

114 I think it likely that Mr Hagemrad mentioned the figure of one person per square metre before the meeting on 9 June 2016. I accept that this is why the figure was used by Mr K Girgis, Mr S Girgis and Mr Chau in preparing their draft cash flow. Mr K Girgis thought it was as early as at the Hyatt presentation. I accept that Mr Hagemrad is likely either to have said to use an 80% capacity or to have agreed it was reasonable to use 80% in the Draft Cash Flow.

115 As to "retail trade", Mr K Girgis stated:

[A]gain, through discussions with Maz, I believe there's an email where I asked what is the, I guess, expected retail revenue, which he replied for conservativeness, use 10 per cent, so that's how I came up with that figure.

116 He noted that the "COGS" (costs of goods sold) and "Advertising" and "Royalty" were prepopulated formulas. Interpolating, these were calculated automatically by the excel spreadsheet from the income inputs.

117 As to the various expenses, Mr Chau gave the following evidence in oral evidence before cross-examination:

"Accounting and Legal Costs": I – I kind of knew how much I pay my accountant, so that's how we came up with that figure. No legal costs were, I guess, included in that; it was all really accounting.

“Bank & Merchant Charges”: just from, I guess, experience in my past businesses, that was put in at one per cent.

“Bookkeeping”: again, I know how much I pay my bookkeeper.

“Electricity” and “Insurance”: was based on, you know, I’ve run facilities that are about 300 square metres and we – I looked at that and said, you know, this is x times larger, so that’s how I kind of came up with that figure. The same with insurance.

“Interest Expenses”: was calculated as a – at the bottom of that spreadsheet it states that we were always expecting to borrow 50 per cent of the start-up costs, which, at the time, we expected to be 500K, so 250K was the borrowing amount at the interest of [at] the time of approximately seven per cent over a seven-year term and that’s how I calculated that figure.

“Office Expenses”: Again, office was just based off what I had kind of known in the past and extrapolated that.

“Rent”: The rental amount came from Maz. He said based on, I think, warehouse or bulky goods at around \$150 a square metre and that’s how we came up with that figure.

“Repairs and Maintenance”: again, just based on what I knew was expecting.

“Salaries & Wages”: again, came from – there’s an email between me and – between Maz and I about what to expect for staff. And at the bottom of the page, it was based on a full-time GM, a full-time fitness director, two sales consultants and some bonuses. So I – that’s how I calculated that figure.

“Superannuation”: Super is a percentage of wages, which is, you know, the standard.

“Telephone”, “Workers’ Compensation” and “Travel Expenses”: And then same with telephone, that was just based off what I knew was – I guess how much phone and internet was at that time. And same with Workers’ Comp and travel was based on, you know, having to travel to – travel to the US for training.

118 Mr K Girgis stated that 800 members was included in the Draft Cash Flow by him, Mr S Girgis and Mr Chau on the basis that it represented 80% of an anticipated membership of 1000 for a 1000 square metre premises. Mr K Girgis accepted that the assumption underlying the model was that there would be 800 members from the first month of operations: T.73.30. Mr K Girgis accepted that he was relying on his experience and the experience of Mr S Girgis and Mr Chau in forecasting gross income: T.74.36. He stated, however, that he also relied on what Mr Hagemrad had said at the presentation on 19 January 2016 that the maximum number of members was 1 per square metre: T.74.7.

119 Mr K Girgis agreed that, at this time, he was aware that neither Mr Hagemrad nor Mr Hussein had operated a gym; that they were located in Sydney; and that there was no UFC gym yet operating in Australia: T.84.6.

120 Mr S Girgis gave evidence in cross-examination that Mr Chau was the “numbers guy”:  
T189.17; T190.6. He could not recall what input he had into the Draft Cash Flow, although  
accepted he would have had input: T190.

***15 June 2016: Second Skype meeting***

121 On 15 June 2016, Mr K Girgis, Mr S Girgis and Mr Chau met with Mr Hagemrad and Mr  
Husseini on Skype. The Draft Cash Flow was discussed. The parties were in dispute as to  
what was said during the Skype conference.

122 In his first affidavit, Mr Chau stated:

23 On 15 June 2016 Karim, Sherif and I had a Skype meeting with Maz and Sam,  
during which we discussed the completed cash flow projections. We went  
through the figures in the cash flow spreadsheet.

24 Maz said that the figures were generally correct, but we needed to make some  
changes to the spreadsheet, including for rental cost at \$150 sqm, and changing  
income projections to provide for a start-up phase which included a two-month  
“presale” period. Maz said that we should assume that members will increase  
at 150 new members initially and then 100 members per month going forward.

25 Following this Skype meeting I updated the cash flow spreadsheet given the  
changes required by Maz and on 17 June 2016 Sherif sent an updated version  
to Maz by email. ...

123 Mr Chau was cross-examined about [24] and his statement that Mr Hagemrad told him to  
change the Draft Cash Flow to include rent at \$150 per square metre. It was pointed out that  
the amount of \$150 per square metre had been used in the Draft Cash Flow and was the same  
in the Updated Cash Flow provided on 17 June 2016 (defined below): T272-3. His evidence  
at T273-4 included:

You had allowed rent at \$150 per square metre, Mr Chau, before you spoke to Mr  
Hagemrad on 15 June 2016, correct?---Yes, correct. That was based on the Hyatt.

Do you need to correct what you say in paragraph 24, about Mr Hagemrad telling you  
on 15 June 2016 to include rental cost at \$150 per square metre?---No. He did say that.  
I’m assuming it was just confirming that it was correct.

Well, what you say in paragraph 24 of your affidavit is that Mr Hagemrad told you to  
include rent at \$150 per square metre. That’s what you say in paragraph 24 of your  
affidavit, correct?---That’s correct. Yes.

By 15 June 2016 - - -?---I - - -

- - - you had already included rent - - -?---Yes.

- - - at \$150 per square metre?---I believe he was – he was just reiterating that that was  
the correct figure.

Well, that’s not what you say in your affidavit, Mr Chau, is it?---Yes. It’s – I assume

that's – that's what he meant.

Mr Chau, my question to you was in your affidavit, you said Mr Hagemrad told you to include rent at \$150 per square metre. That's what you say, isn't it?---That's correct. That's what it says in the affidavit.

You're now saying that he said something different, correct?---No. I'm not saying he said something different. The – he did say that the rent is at \$150 per square metre on the call, so I assume he's reiterating that that is the correct figure.

Mr Chau, you have no real recollection of this conversation, do you?---No, I do. I definitely do. Yes. That was - - -

In your affidavit, you say that Mr Hagemrad told you to include something in the cash flow document which you had already included. That's the case, isn't it?---He reiterated that it was \$150 a square metre, or he said that it was 150 per square metre is what we should be anticipating.

124 The difficulty with Mr Chau's evidence is that [24] of his affidavit states that Mr Hagemrad told him to change the amount of \$150 per square metre. It is not reasonably read as stating that Mr Hagemrad reiterated the figure. There would be no reason for Mr Hagemrad to have done that.

125 In his first affidavit, Mr K Girgis stated:

17 On 15 June 2016 we had a second Skype meeting with Maz Hagemrad and Sam Hussein. During this meeting we discussed the business plan and the cash flow projections in detail.

18 During this meeting Maz and Sam said that the income projections should be adjusted for a pre-sale phase and then operations where I [sic] the pre-sale phase we should assume membership increasing 150 per month and then 100 per month.

19 After this Skype meeting, Paul updated the cash flow spreadsheet and this was sent to Maz on 17 June 2016, as set out in Paul's affidavit.

126 During cross-examination, Mr K Girgis readily and appropriately conceded that the words "and Sam" should be deleted from [18] of his affidavit. He agreed that what had been said was said by Mr Hagemrad.

127 Mr Hagemrad's affidavit evidence included:

18 I refer to paragraphs 17 and 18 of the Karim affidavit and paragraphs 23 and 24 of the Chau affidavit. A video conference was held via "Skype" with Paul, Karim and Sherif on 15 June 2016. During that video conference I deny I made any statement about the "figures" of the applicants or whether they were "correct". I recall saying words to the effect "The business plan and cashflow are for the purpose of getting franchisee approval from the US. They will review your background experience, net worth, business plan detail and your understanding of a cashflow projection". I deny I said to the applicants "you should assume that members will increase at 150 new members initially and

then 100 members per month going forward”. I do not recall any discussion about anticipated membership growth in that meeting as at that time no UFC Gym had opened in Australia and those type of projections were something I would have deferred to Jason Laurence given his experience with opening new gyms ... In relation to the [cashflow] spreadsheet, I do recall saying during the Skype call words to the effect “I think just inserting the same figures across all months of the cashflow would likely raise concerns with the US franchisor. It would show a lack of the basic understanding of building a business plan.” However, I did not suggest any specific figures for the cashflow spreadsheet.

128 In his second affidavit, Mr Chau stated:

9 As to paragraph 18 [of Mr Hagemrad’s affidavit], one of the purposes of the Skype call was to go through the business plan and cashflow that was to be submitted to the US. During the call Maz specifically said words to the effect that we should make changes including a ramp up of growth during pre-sales and after opening. I had no experience with a big box gym like UFC so I was relying on Maz to provide guidance as to the figures. Maz told us the presales figures we used in the cashflow spreadsheet.

129 In his reply affidavit, Mr K Girgis stated:

11 As to paragraph 18, both Maz and Sam said words to the effect that the figures were correct and in line with “their model”. Maz said words to the effect:

- (a) both the cashflow and business plan needed to be accurate for them to be approved by the US and themselves (which I took to mean Maz, Sam, John and Jim);
- (b) we should assume that the initial growth would be 150 members per month and then 100 members per month after that, he said that first year growth would be consistent because the members sign onto a 12-month contract;
- (c) he would review the documents to be sent to the US for approval.

130 There was extensive cross-examination on the opening sentence of this paragraph. It was suggested that Mr K Girgis would have included the first sentence in his first affidavit if he truly had a recollection to the effect stated. Mr K Girgis agreed that he had read Mr Chau’s affidavit when making his reply affidavit. Mr Chau’s affidavit contained evidence to similar effect as the first sentence of [11] of Mr K Girgis’s reply affidavit.

131 In cross-examination, Mr Hagemrad denied going through the Draft Cash Flow line by line: T474.11. Mr Hagemrad stated he could not recall whether he said to Mr K Girgis, Mr S Girgis and Mr Chau that “the figures [were] generally correct”: T474.45. He thought he may have discussed a pre-sale period of about two months: T475.2. He also stated that “pre-sale at that point in time wasn’t part of my fitness knowledge” T474.20.

- 132 Mr Hagemrad accepted that he had stated that using the same figures across all months might raise concerns when the application came to being assessed by the Master Franchisor in the USA: T474.40. This might also be explained by the desire expressed in the Cash Flow Template's Assumption 1 that "gross income is expected to increase by a sustainable 3% each month".
- 133 In cross-examination, Mr Hussein first stated that the particular line items in the Draft Cash Flow were not discussed individually; they were discussed "holistically, not item by item": T564.1. He then agreed that some line items were discussed but he could not remember which ones: T564.8.
- 134 On balance, I consider it unlikely that Mr Hagemrad stated that the figures were "correct", in the sense of conveying that all of the figures in the cash flow worksheet were correct.
- 135 It was also suggested to Mr K Girgis in cross-examination that Mr Hagemrad had not stated to use 150 members per month initially and then 100 members. It was put to him, and he readily agreed, that there was no contemporaneous note to that effect.
- 136 In cross-examination, Mr Hagemrad denied that he recommended using 150 new members per month initially and then 100: T474.28; 474.34. Mr Hagemrad was cross-examined about his statement at [18] of his first affidavit that he would not have stated to use 150 members initially for reasons including that "those type of projections were something I would have deferred to Jason Laurence given his experience with opening new gyms". Mr Laurence had not commenced his role with UFC at this time. As noted earlier, his contract provided for him to start on 1 July 2016 or later agreed and Mr Laurence's evidence was that he started in October 2016.
- 137 A revised cash flow was sent by Mr S Girgis two days later and this used 150 members for the first month (November 2016), 300 for the second month (December 2016) and then increasing by 100 a month, reaching 800 members by May 2017.
- 138 On balance, it is likely that Mr Hagemrad suggested the change to using 150 members in each of the first two months in the Skype meeting.

## 17 June 2016: Updated Business Plan and Updated Cash Flow

139 On 17 June 2016, Mr S Girgis sent an email to Mr Hagemrad and Mr Husseinini attaching an “updated business plan and cash flow”. The amendments to the business plan included a statement that it “will take time and money” to establish a UFC Gym in Australia.

140 Item 2 of the analysis of “Strengths” now provided the following comment:

Karim and Sherif have vast experience in business and in the fitness industry and currently own and operate multiple successful businesses. These skills are transferable to the UFC gym venture and therefore we understand how to effectively implement strategy and operate a business of this nature

141 The cash flow worksheet attached to the email of 17 June 2016 was updated by Mr Chau (Updated Cash Flow). It was as follows:

12 Month Cash Flow Worksheet																			
Receipts															Budgeted Achievable Scenario				
	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	Total
Gross Income <sup>1</sup> (Incoming Dues)	18000	36000	48000	60000	72000	84000	96000	96000	96000	96000	96000	96000	96000	96000	96000	96000	96000	96000	1,152,000
Retail (merchandise/F&B)	1,800	3,600	4,800	6,000	7,200	8,400	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	9,600	115,200
Total	19,800	39,600	52,800	66,000	79,200	92,400	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	105,600	1,267,200
Direct Costs																			
Purchases <sup>2</sup>	900	1,800	2,400	3,000	3,600	4,200	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	57,600
COGS (50%)	900	1,800	2,400	3,000	3,600	4,200	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	4,800	57,600
Sales Rec Less Direct Costs	18,900	37,800	50,400	63,000	75,600	88,200	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	100,800	1,209,600
Advertising (2%) <sup>3</sup>	396	792	1,056	1,320	1,584	1,848	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	2,112	25,344
Royalty (10%) <sup>3</sup>	1,980	3,960	5,280	6,600	7,920	9,240	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	10,560	126,720
Gross Profit	16,524	33,048	44,064	55,080	66,096	77,112	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	88,128	1,057,536
Trade Payments																			
Accounting & Legal Costs	194	195	196	197	198	199	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Bank, Merchant Charges & Interest	1,658	1,856	1,988	2,120	2,252	2,384	2,516	2,516	2,516	2,516	2,516	2,516	2,516	2,516	2,516	2,516	2,516	2,516	30,192
Bookkeeping	135	135	135	135	135	135	135	135	135	135	135	135	135	135	135	135	135	135	1,620
Electricity	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	48,000
Gas																			
Insurance	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Office Expenses	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300	3,600
Rent	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	150,000
Repair & Maintenance	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Salaries & Wages	4,950	9,900	13,200	16,500	19,800	23,100	26,400	26,400	26,400	26,400	26,400	26,400	26,400	26,400	26,400	26,400	26,400	26,400	316,800
Superannuation <sup>4</sup>	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	24,000
Telephone	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Workers' Compensation	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Travel expenses	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	500	6,000
Other Payments	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Total Trade Payments	29,037	34,186	37,619	41,052	44,485	47,918	51,351	51,351	51,351	51,351	51,351	51,351	51,351	51,351	51,351	51,351	51,351	51,351	616,212
Net Operating Cash Receipts	(12,513)	(1,138)	6,445	14,028	21,611	29,194	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	441,324
Less Corporate Tax Instalments	(6)	(5)	(4)	(3)	(2)	(1)	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Trade Receipts	(12,507)	(1,133)	6,449	14,031	21,613	29,195	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	36,777	441,324
Hire Purchase Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank Loan Repayments Approx	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	2,900	34,800
Subtotal	(15,407)	(4,033)	3,549	11,131	18,713	26,295	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	406,524
Plus Capital Receipts																			
New Loan	(6)	(5)	(4)	(3)	(2)	(1)	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Cash Flow	(15,413)	(4,038)	3,545	11,128	18,711	26,294	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877	33,877
Opening Cash Balance								33,877	67,754	101,631	135,508	169,385	203,262	237,139	271,016	304,893	338,770	372,647	372,647
Closing Cash Balance	(15,413)	(4,038)	3,545	11,128	18,711	26,294	33,877	67,754	101,631	135,508	169,385	203,262	237,139	271,016	304,893	338,770	372,647	406,524	406,524

### Assumptions:

- Gross income is expected to increase by a sustainable 3% each month. This is conservatively applied given the location
- COGS for merchandise should be approximately 50%.
- Advertising & royalty expenses are fixed to 2% & 10% of the gross income respectively.
- 9.5% of gross salary & wages are subject to superannuation

Income - expected revenue at 80% of capacity with each member paying \$30 a week. No income growth factored in for conservativeness  
 retail sales - 10% of revenue  
 COGS - 50% of retail sales

Interest expense - 50% borrowing (250k) at 7% interest over 7yrs with principal and interest repayments  
 rent - 1000sqm at \$150/sqm gross based on current commercial spaces available in WA  
 wages - 25% of Revenue

142 Mr Chau gave evidence that the main changes to the Draft Cash Flow were to: (a) include a ramp-up or pre-sale period; (b) electricity; and (c) wages. His evidence at T234 was:

Can I ask you to explain what changes you made from the last version of the cashflow to this one and why?---Sure, okay. Again, from just from the top, probably one of the biggest changes was after discussion in the Skype call with Maz, was that he said we would need to have a – a ramp-up or presale period, which made sense, and he said, “Expect to grow at 150 members for the first two months of presale,” and then we would open and then expect, like, a 100-member growth from there, and that’s what I had inputted until we reached that 80 – 80 per cent capacity, which was from the previous spreadsheet. That was one of the major changes. The other major change was the electricity amount. He said we probably were underbudgeting for electricity, and that’s why it has been increased there to double what we were expecting. And finally, in terms of wages, he said we should aim for a 25 per cent of gross, and that’s what I’ve inputted to account for, you know, the ramp-up period and then when – when we become operational. I think they’re the three major changes from that spreadsheet. Yes, that’s – they’re the changes.

143 The Draft Cash Flow and the Updated Cash Flow both include a projection of total revenue in the sum of \$1,267,200, comprising total gross income from fees (\$1,152,000) and retail sales (\$115,200). The main change to receipts was to include a pre-sales phase commencing in November 2016.

144 The main changes to the expenses were to:

- double the cost of electricity from \$24,000 to \$48,000;
- increase “Salaries & Wages” from \$240,000 per year to \$316,800 per year;
- merge (although not quite exactly) what had been “Bank, Merchant Charges & Interest” and “Interest” in the Updated Cash Flow, rather than having them as separate line items.

145 The Updated Cash Flow continued to contain a row for “Hire Purchase Repayments”, which contained no expense, consistently with the fact that no-one had suggested equipment would be on operating lease. The “Superannuation” row contained an error because it continued to show a fixed amount of \$2000 per month (as depicted in the Draft Cash Flow) when it should have increased in line with the updated increase to “Salaries & Wages”. The end result was that “Net Trade Receipts” which had been \$542,148 in the Draft Cash Flow reduced to \$441,324 in the Updated Cash Flow.

***24 June 2016: Emails from Life Fitness to Mr Hagemrad***

146 On 24 June 2016 at 10.02pm, Mr Oman of Life Fitness sent an email to Mr Hagemrad, with the subject “Email 1 – Wetherill Park”, which included:



Firstly, thanks for the walk through at the site today. I am really positive about the future of UFC here with sites like these in the mix. As discussed today, I feel that it will be easy to sell a 800m<sup>2</sup> club to a potential franchisee, when walking through the Wetherill Park club. The product list is scalable and there are some simple changes that can be made to the different training zones to fit a smaller location. Hopefully Wetherill Park will be complete with Hammer Strength and Life Fitness products, as I am sure they will play an important part in the growth of the brand here in Australia.

I have attached a revised proposal for Wetherill Park with this email. There aren't many changes to the equipment list, except for the added Tiyr and Multi Plyo Boxes. The big addition is the deferment of payments for 4 months on the finance. I have approval from my CEO to deliver the goods with a single initial payment. The 4 months following the installation of the goods, will see a hold placed on your finance with no payments due. After these 4 months have passed, the finance will recommence with 47 more repayments to be made to complete the contract.

...

I will send you a separate email about the Franchisee pricing, but I have made some changes as we had discussed this afternoon.

147 The “equipment proposal” attached was for \$288,560 plus GST of \$28,856, a total of \$317,416. It related to: (a) Life Fitness “Discover SE” cardiovascular equipment and Life Fitness strength equipment; and (b) Hammer Strength equipment, including free weights.

148 On 24 June 2016 at 10.29pm, Mr Oman sent an email to Mr Hagemrad which included:

Whilst I was driving home, I had a think about the discussion we had around the \$700,000 cost that you are indicating to potential franchisee. I know this has been designed to accommodate the fit out costs and the costs of equipment, but it really doesn't need to. When you show a \$700,000 cost in fitting out a facility, you are indicating that the equipment will cost the client \$350,000.... But that isn't really the case.

The equipment will be a monthly expense to the franchisee, and will have only a small impact on their capex initially. Whilst they will need to pay for the builder, the franchise fees and some of the soft accessory products up front, the bulk of the equipment will be leased over a longer period through our internal finance.

A new franchisee will only be liable for around \$8,000 before they open the doors (their first monthly repayment). After that, the equipment repayments are simply a monthly expense on the budget and are considered in their profit and loss projections.

Whilst I agree that you should indicate to a franchisee the equipment list that they need to include when they open, I think the monthly figure is the only amount that you should discuss when talking figures. It is much more relevant than a cash investment lump sum, which suggests that the client needs a much greater amount of working capital than they do. It is more important that a future UFC franchisee has some working capital for the first 4 to 6 months of business as the member numbers are growing.

149 On 24 June 2016 at 10:32pm, Mr Oman sent an email to Mr Price (related to the email with the subject “Email 1 – Wetherill Park”) which included:

Email 2. This is the pricing for franchisees. Maz was discussing how they want the proposal to reflect an overall spend of \$700k to potential franchisees. (I.E. You can open a UFC for \$700K).

However you can open a UFC for far less than that, as the equipment should be viewed as an operating expense and not a lump sum cost.

No franchisee will pay for the products up front, so they are really just an operating cost of the business. I would be promoting to UFC franchisees that they can open a club for \$400K, and that their break even in a typical 800m<sup>2</sup> site is 400 members or thereabouts.

150 Mr Hagemrad's evidence included:

Is that where you got the idea for promoting UFC gyms on the basis that the leased equipment was outside the establishment costs?---Sorry, rephrase that.

Yes. Is this email where you got the idea for treating operating lease costs as not being establishment costs?---I wouldn't say specifically, no.

***1 July 2016: First Disclosure Document and draft franchise agreement***

151 On 1 July 2016, UFG's solicitors provided to the solicitors for the Balcatta Franchisee a disclosure document dated 31 March 2016 (**First Disclosure Document**) and a draft franchise agreement.

152 Clause 3.1 of the First Disclosure Document included:

**3. Business experience**

3.1 A summary of the relevant business experience of each person mentioned in item 2.8 for the past 10 years, including length of experience in:

- (a) working in the franchise system; and
- (b) working for the franchisor:

Name	Position held with franchisor	For the past 10 years, a summary of the relevant business experience of each person	For the past 10 years, length of experience working in the franchise system and length of experience working for the franchisor
Maz Hagemrad	CEO	Mr Hagemrad has been a Subway Franchisee since 2003. He was elected on the Subway Franchisee Advertising Fund Board for 9 Consecutive Years and Chairman of the Board for 7 consecutive years. He also led a team that pioneered Frozen Yogurt in the Australian Market by developing a	Maz was involved in the negotiations with UG Franchise Operations, LLC since 2013. He played a pivotal role in securing the master territory agreement for the Franchisor's Australian operation. Maz was formally appointed as CEO of the

		Franchise model in 2005. He has also held a position of Sports Physiotherapist in his private practice and with elite sporting teams since 2001.	Franchisor in 2015, when Ultimate Franchising Group Pty Ltd was incorporated.
Samer Hussein	Sole Director and Business Development Manager	Samer Hussein graduated from Western Sydney University with a bachelor degree in computing, majoring in systems and information technology. With over 20 years' experience in the corporate world, Sam has worked for many international and national companies such as Cathay Pacific, IBM and Woolworths Limited. Sam was owner/director of his own IT company where he had over 5 employees.	Samer was involved in the negotiations with the UG Franchise Operations, LLC since 2013. He played a pivotal role in securing the master territory agreement for the Franchisor's Australian operation. Samer has been the sole director of Ultimate Franchising Group Pty Ltd since 2015.

153 As mentioned earlier, clause 4, entitled “Litigation”, falsely stated “Not Applicable” – see: [90] and [91] above.

154 The First Disclosure Document included clauses 14.3 to 14.5 which provided:

#### **14. Other payments**

...

#### **Establishment costs**

14.3 Details of the range of costs to start operating the franchised business, based on current practice, for the following matters:

- (a) real property, including property type, location and building size;
- (b) equipment, fixtures, other fixed assets, construction, remodelling, leasehold improvements and decorating costs;
- (c) inventory required to begin operation;
- (d) security deposits, utility deposits, business licences, insurance and other prepaid expenses;
- (e) additional funds, including working capital, required by the franchisee before operations begin;
- (f) other payments by a franchisee to begin operations.

The information for item 14.3 is set out in Table 1 of Schedule 5.

14.4 For item 14.3, the details for each payment must include:

- (a) a description of the payment; and

- (b) the amount of the payment or the formula used to work out the payment; and
- (c) to whom the payment is made; and
- (d) when the payment is due; and
- (e) whether the payment is refundable and, if so, under what conditions.

The information for item 14.4 is set out in Table 1 of Schedule 5.

14.5 For item 14.4, if the amount of the payment cannot easily be worked out-the upper and lower limits of the amount.

155 In relation to cl 14.5, which referred to “upper and lower limits”, Mr Hagemrad’s evidence was:

And did you understand the concept of a limit to refer to a maximum and a minimum estimate?---No.

No?---No.

Did you understand it to be a best guess as to what the amount was going to be?---I understood it to be an estimate.

You didn’t consider that you should look for an estimate of what the maximum cost could be in relation to a franchisee?---No, not as an absolute.

Isn’t that the concept of a limit as you understood it, Mr Hagemrad?---No. As I said, I understood it to be as an estimate.

156 Schedule 5 was entitled “Item 14 Tables of establishment costs and payments”. It commenced with a box:

*The information on the following pages sets out the range of costs usually encountered by a new franchisee when establishing a franchised business based on current practice.*

*This information is provided as a guide only and is not to be taken as a guarantee.*

*The information provided includes a number of assumptions which WILL VARY depending upon many factors dependent on the specific circumstances of each individual franchise; the franchisee’s management skill, experience and business acumen; the existing assets of the franchise and local economic conditions and the suppliers.*

*The assumptions are given to assist the franchisee’s independent financial advisers to form their own view on the financial information and likely variances or additional costs in the context of the franchisee’s specific circumstances.*

157 In cross-examination, Mr K Girgis stated that he did not recall reading this at the time. He said his eyes would have been drawn to the costs set out in Table 1 on the page and that he would have paid more attention to those matters. He did not deny reading it, accepted he may have read it and stated that he skimmed many things. He accepted he would have understood the

following sentence, if he had read it at the time: “This information is provided as a guide only and is not to be taken as a guarantee”.

158 Mr S Girgis believed that he read the material in the box: T214.37. He gave the following evidence at T214-5:

And you understood that from what was in the boxed section that this document was not telling you what the establishment costs would actually be; that’s the case, isn’t it?---I wouldn’t put it like that.

Well, Mr Girgis, can you see the words “will vary”?---Yes, I can.

You can see that they are in capitals?---Yes.

And that they are underlined?---Yes.

And what that is stating is that these costs will – I withdraw that. You understood from that that it was conveying that the actual costs will vary from the costs stated in table 1; that’s the case, isn’t it?---Yes, they will vary.

159 Table 1 of the First Disclosure Document set out establishment costs for a prospective franchise business, totalling \$504,000 to \$820,000 plus certain identified costs for which no specific amount was indicated. It provided:

**Table 1: Establishment Costs (Items 14.3, 14.4 and 14.5)**

Expenditures	Description of payment	Amount of the payment or the formula used to work out the payment	To whom the payment is made	When the payment is due	Whether refundable; if so, under what circumstances
(a) Real property (including property type, location, and building size)	Leasing up front costs including your legal costs of reviewing lease and the like	\$3,000 - \$5,000	Your solicitor and other third party suppliers	around the time of signing lease	Not refundable
	Costs of applying for development approval from the local council, if required	Will vary depending on site, Council and zoning	Your town planner	As required by town planner	Not refundable
(b) Equipment, fixtures, other fixed assets	Lease or purchase of equipment	\$250,000 - \$350,000	Franchisor, Various other suppliers	Prior to opening and upon purchasing	Not refundable
(c) construction, remodelling, leasehold investments, decorating costs	Building, construction and fitout costs	\$190,000 - \$360,000 (approx. \$300 psm)	Franchisor and Various contractors	Prior to opening during building stage	Not refundable

(d) Inventory required to begin operation	Merchandise, Drinks and supplies	\$6,000 - \$10,000	Franchisor	Prior to opening	Not refundable
(d) Security deposits, utility deposits, business licences, insurance and other prepaid expenses	Deposits for Electricity, Insurance etc	Varies based on supplier	Your preferred supplier	Prior to opening	Yes
(e) Additional funds (including working capital, required by the franchisee before operations begin)	Required capital to maintain the business operations	Estimated 3-6 months working capital dependent on rent \$35,000 - \$65,000	Third Parties	As incurred	Not refundable
(f) Other payments by a franchisee to begin operations	Travel expenses for training, Pre-opening advertising	\$20,000 - \$30,000	Third parties	Prior to opening	Not refundable

160 Table 2 of Schedule 5 provided:

**Table 2: Recurring or isolated payments to the franchisor or an associate of the franchisor**

**For each recurring or isolated payment payable by the franchisee to the franchisor or an associate of the franchisor or to be collected by the franchisor or an associate of the franchisor for another person:**

(a) Description of payment	(b) Estimated amount of estimated low-high range or formula (excluding GST)	(c) To whom the payment is made	(d) When the payment is due	(e) Whether refundable; if so, under what circumstances
Initial Franchise Fee	\$60,000 plus GST	Franchisor	On or before signing franchise agreement	Not refundable except in accordance with cooling off rights specified under clause 3.4 of the Franchise Agreement
Royalty Fee	10% of Net Revenue plus GST	Franchisor	Fortnightly	Not refundable
Software Support Fee	\$400 - \$600 plus GST	Supplier	Monthly	Not refundable
Additional Training Fees	\$700 plus GST per day per person excluding travel and accommodation	Franchisor	Prior to commencement	Not Refundable

Transfer Fee	\$15,000 plus GST	Franchisor	At the time of the transfer	Not Refundable
Renewal Fee	30% of the ten current initial franchise fee plus GST	Franchisor	At the time of the renewal	Not refundable except in accordance with the code
Manual Replacement Fee	\$350 plus GST for Each Manual	Franchisor	Upon receipt of Invoice	Not Refundable
Site Review Fee	\$1,950 plus GST	Franchisor	Upon site selection	Not Refundable
Advertising Contribution	2% of Net Revenue plus GST for Sites up to 2000sqm (known as 'Boutique' sites) 1% of Net Revenue plus GST for Sites >2000sqm (Known as 'Signature' sites).	Franchisor	Monthly	Non refundable
Pre-sale Marketing Kit	\$6,000 - \$8,000 plus GST	Franchisor	Prior to commencing Pre-Sale period	Non refundable

161 Table 3 of Schedule 5 provided:

**Table 3: Recurring or isolated payment to persons other than the franchisor or an associate of the franchisor:**

**For each recurring or isolated payment, that is within the knowledge or control of the franchisor or is reasonably foreseeable by the franchisor, that is payable by the franchisee to a person other than the franchisor or an associate of the franchisor (exclusive of GST):**

Description of payment	Estimated amount or estimated low-high range or formula	To whom the payment is made	When the payment is due	Whether refundable; if so, under what conditions
Rent	\$10,000 - \$25,000	Landlord Agent	Monthly	Not Refundable
Electricity	\$3,000 - \$5,000	Supplier	Monthly	Not Refundable
Phone and Internet	\$300 - \$1,000	Supplier	Monthly	Not Refundable
Foxtel	\$80 - \$150	Supplier	Monthly	Not Refundable
Primary Marketing Area advertising expenditure	2% of Gross Revenue	Supplier	Monthly	Not Refundable
Legal fees for the preparation of franchise documents for new prospective franchisee	\$3,000 plus GST and disbursements	Franchisor's legal representatives	On or before entering the Franchise Agreement	Not Refundable
Legal fees for Premises documentation including lease and	\$3,500 - \$5,000 plus GST and disbursements	Franchisor's legal representative	On or before entering the Franchise Agreement	Not Refundable

sublease or outlet licence				
Insurance	\$5,000 - \$10,000	Supplier	Annually	Pro rata if cancelled.

162 After Table 3, there appeared the following:

**IMPORTANT NOTE:**

The franchisor makes no representation that the information contained in this Schedule covers the full range of expenses or outgoings experienced by the franchisor's franchisees. Whilst the information is indicative of the types of reasonably foreseeable expenses that a franchisee operating a franchise might incur, it is not intended to provide an exhaustive list of expenses that a franchisee may incur, as each franchise and franchisee is unique.

The franchisor cannot estimate the expenses or outgoings of any franchisee or franchised business as these may vary widely between franchises and franchisees and are subject to a number of factors that are beyond the control of the franchisor including (but not limited to) the following, many of which may change over time and differ from location to location:

- the efforts and personal commitment of the franchisee and its directors and staff and how hard they are prepared to work;
- the skills and ability of the franchisee, its directors and staff;
- the franchisee's compliance with the system;
- the length of time the franchisee has operated the business;
- the management and other relevant experience of the franchisee and/or its directors and staff;
- competitor activity;
- the sales ability of the franchisee and its staff;
- the franchisee's pricing policy;
- the standard of customer service provided to customers of the franchisee;
- the franchisee's training and management of staff;
- the demographics (including without limitation, the level of disposable income and age) and socio-economic conditions of the area where the store is located and in nearby areas;
- rent and occupancy costs;
- wage costs;
- the franchisee's marketing ability and willingness to utilise appropriate marketing devices;
- the franchisee's ability to manage its financial position;
- the franchisee's debt to equity ratio and its finance arrangements;
- the prevailing economic climate and general business conditions as well as



those in the area where the franchise is located and nearby areas;

- regulatory requirements.

By providing this information, neither the franchisor nor any other person gives any guarantee or makes any representation about the likely success or failure of the franchisee.

Neither the franchisor nor any other person gives any guarantees, warranties, or assurances in relation to the potential of expenses or outgoings, if any, or targets for any particular store that a prospective franchisee is considering purchasing. Each prospective franchisee must make their own detailed inquiries and investigations to potential sales, income, expenses and profitability, if any, for any particular franchise that they are considering purchasing, and set their own financial targets.

163 Mr K Girgis could not remember whether he read the “Important Note” section at the time. I doubt that it was read by him in any detail.

164 Mr S Girgis stated that he could not specifically recall reading the note, but appeared to accept that he did: T215. He said he understood from it that the amounts could vary.

165 Mr Chau gave evidence which included (at T298):

When you read the disclosure document and specifically noted figures on page 315, is there any reason why you would not have also read the boxed section on page 315?---I probably did read it. I just don’t recall. I was focused on the numbers.

And having read – by reading what was in the boxed section on page 315 and the important note on page 320, you knew that this was not setting out what the establishment costs would actually be, you knew that, didn’t you?---I knew this was a – it was a guide. Yes. I knew it would – there would be variances.

166 Clause 32.8 of the draft franchise agreement was an “Entire Agreement” clause which required the prospective franchisee to reduce to writing any representations relating to the grant of the franchise. It provided:

### 32.8 Entire Agreement

The background, Schedules and Annexures to this Agreement and any other documents expressly associated with the grant of the Franchise, such as the Disclosure Document and Prior Representations Deed, constitute the entire Agreement between the parties. If you believe that there are or have been oral or written representations between us and you relating to the grant of this Franchise then you must ensure that these oral or written representations are reduced to writing and contained in the Prior Representation Deed. We rely upon the accuracy of the representations that are reduced to writing that are contained in this Agreement or the Prior Representations Deed (and the questionnaire attached to it) before executing this Agreement.

167 No representations were ultimately “reduced to writing” pursuant to this clause.

**12 and 16 July 2016: Emails:**

168 On 12 July 2016, Mr Chau sent an email to Mr Hagemrad, copied to Mr K Girgis and Mr S Girgis, about fit out costs, indicating a degree of scepticism about the costs which had been indicated. His email stated (errors as per original):

Hi Maz

I know that it had been estimated that we will require about 500 - 600k to start up the gym but just wondering if you have anymore detail you can provide us on this.

The costs which I am would like some clarification on is fitout. I guess you guys will be working off the fitout guide to determine a rough estimate so wondering if there has been some quotes received to come up with that figure?. If there has been can you break it down for us such as flooring, plumbing, lighting, AC etc.

I just want to make sure we budget sufficient funds for the project. To start up a Jetts gym of 300 - 400 sqm cost about 500-600k which is why Im a bit skeptical to how a 1000sqm gym would cost similar considering the cost of equipment for both business are similar (approx 250k - 300k).

169 Mr Hagemrad responded on 16 July 2016, copying Mr K Girgis, Mr S Girgis and Mr Hussein. He stated that estimates for fit-out costs were “a best guess scenario based on our preferential agreements with suppliers” and “subject to final quotations for each individual site” (errors as per original):

Hi Paul,

At this stage our indicatives are a best guess scenario based on our preferential agreements with suppliers. The budgeting ranges are as follows, please note these remain indicative and are subject to final quotations for each individual site:

- Fit out: \$220 - \$280 psm
- Flooring (supply and install) \$60 - \$80 psm
- AV: \$15 - \$25 psm

All other fitout costs are factored into the ‘Fitout’ item line above including plumbing, electrical, lighting etc.

As for AC, we will endeavour in all our leasing negotiations to include AC as a Lessor’s works item. AC is a substantial c[a]pital expenditure and would be cost prohibit[i]ve for franchisees to bare that cost.

170 In cross-examination, Mr K Girgis agreed that Mr Hagemrad was only giving a best guess estimate and that various matters would affect the cost, including the age and condition of the premises. His evidence also included:

The economic conditions at the time that the work was to be carried out could also affect the actual cost, correct?---That’s possible, of course.

So you understood that the figures which Mr Hagemrad set out in his email were not

intended to indicate the actual cost of the fit-out. That is how you understood this email when you read it in 16 July 2016; is that correct?---I understood it to be a range, and they had preferential agreements that they were working on, so it was getting close.

Well, my question to you was this, Mr Girgis: you understood that this email was not indicating to you what the actual costs of any premises would be once they had been identified; do you agree with that?---Yes, not specifically, no, that's right.

171 Mr S Girgis was also cross-examined in relation to these emails. He agreed that, at the time of the emails, no premises had been identified. He agreed that he knew that no timetable had been scheduled as to when fit-out might be commenced. He accepted that he knew the fit-out cost could be affected by the age and condition of the premises and the economic conditions at the time the fit-out would be carried out. He knew that the estimate was a "rough estimate".

***17 July 2016 to September 2016: Pause to UFG Gym project; opening new F45 studio***

172 On 17 July 2016, Mr K Girgis sent an email to Mr Hagemrad in which he stated that a decision had been made "to hold off on the UFC Gym project for now", but that they were still very interested and would probably go ahead later in the year or early the next year. He also wrote:

We don't believe we've done our due diligence upto scratch and given our current situation, it wouldn't be an intelligent business decision to rush into this.

173 On 23 September 2016, Mr Chau sent an email to Mr Hagemrad stating that "[w]e have all been very busy lately as we have another F45 opening soon and have been focusing on that" and asking how the UFC gym openings were going. He asked whether there was an opening date, referring to a gym due to open in Wetherill Park, Sydney, and stated that "we would be interested in flying over for the opening". He also asked whether there were now "any firm costings now that you guys are close". Mr Hagemrad responded the same day advising the new club would be opening in early November. His response included: "As for costings they are per our original estimations."

***31 October 2016: Second Disclosure Document***

174 A **Second Disclosure Document** dated 31 October 2016 was prepared by Mr Hagemrad. It was not sent to Mr K Girgis, Mr S Girgis and Mr Chau at this time. The Second Disclosure Document is discussed further below at [201].

175 However, it is relevant to note that Table 1 of Schedule 5 now included:

**Table 1: Establishment Costs (Items 14.3, 14.4 and 14.5)**

Expenditures	Description of payment	Amount of the payment or the	To whom the	When the payment is due	Whether refundable; if so, undue
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		formula used to work out the payment	payment is made		what circumstances
...					
(b) Equipment, fixtures, other fixed assets	Lease or purchase of equipment	\$300,000 - \$500,000	Franchisor, Various other suppliers	Prior to opening and upon purchasing.	Not refundable
(c) construction, remodelling, leasehold investments, decorating costs	Building, construction and fitout costs.	\$300,000 - \$450,000	Franchisor and Various contractors	Prior to opening during building stage.	Not refundable
...					

176 The expense ranges of \$250,000 - \$350,000 and \$190,000 - \$360,000 set out in the First Disclosure Document were replaced with \$300,000 - \$500,000 and \$300,000 - \$450,000 respectively in the two rows depicted above. As explained further below, the amount of \$300,000 to \$500,000 for “lease or purchase of equipment” included the amount payable for the Life Fitness and Hammer Strength equipment. Mr Hagemrad had been provided with a quote for this equipment for Wetherill Park in the amount of \$288,560 plus GST on 24 June 2016 – see: [147] above. Other gym equipment was required in addition to this equipment, in particular the UFC Branded gym equipment which Mr Hagemrad must have known cost around \$200,000. As discussed later, although Mr Hagemrad found himself unable to accept the proposition (T480), the amount of \$300,000 - \$500,000 was intended to cover all equipment, whether leased or purchased.

177 On 23 November 2016, Mr Chau sent an email to Mr Hagemrad stating that he, Mr K Girgis and Mr S Girgis had spoken to Mr Ken Lam, a Melbourne franchisee. His email stated: “[w]e asked him a bunch of questions which he was happy to answer” and continued “[w]e are keen to continue our due diligence”.

### ***5 December 2016: Wetherill Park gym opens***

178 The Wetherill Park gym opened on 5 December 2016: T477.44.

179 Mr Laurence confirmed that the Wetherill Park gym had a pre-sale period of about nine to twelve weeks: T448.35. In that period, it obtained 905 members: T448.39. In the first week of opening, somewhere between 35% and 40% of those 905 members were “either cancellations or failed payments”: T448.46. He agreed that it was his experience in the gym industry that cancellations after pre-sale are not unusual: T449.2. Mr Laurence said he did not know whether

any of the prospective franchisees were told about the cancellations, but denied that Mr Hagemrad had told him not to disclose the cancellations to the prospective franchisees: T449.8

180 Mr Hagemrad considered there was a pre-sale period of about 9 weeks, could not remember the number of members obtained in the pre-sale phase and thought that between 35% and 40% of the members failed or cancelled: T494-5. He agreed that failures and cancellations were experienced in other UFC gyms that opened over the couple of months following the opening of the Wetherill Park gym: T495.6. Mr Hagemrad accepted that he did not tell the franchisees about the failures and cancellations in membership: T295.28.

***10 December 2016: Visit to Wetherill Park***

181 On 10 December 2016, Mr K Girgis and Mr S Girgis visited the Wetherill Park gym. Mr Chau was not present. Mr Hussein and Mr Hagemrad were also present.

182 In his first affidavit, Mr K Girgis stated:

- 26 On 10 December 2016 Sherif and I had a tour of the Wetherill Park gym. During this tour I asked Sam Hussein about the cost of the Life Fitness equipment. I asked him, "What about the cost of the cardio and resistance equipment, are they included in the startup cost estimate?". Sam responded, "I'm pretty sure it's all included in the costs we've sent through, but you should check with Maz."
- 27 After the tour of the Wetherill Park Gym, I asked Maz Hagemrad about the cost of the gym equipment.
- 28 I asked Maz, "Is the cost of the cardio and resistance equipment included in the startup cost?" Maz responded, "The equipment is already accounted for in the initial cost estimate in the disclosure document."

183 In his first affidavit, Mr S Girgis stated:

- 15 On 10 December 2016 Karim and I had a tour of the Wetherill Park gym. During this tour Karim asked Sam Hussein about the cost of the Life Fitness equipment.
- 16 Karim asked was the cost of the gym equipment included in the startup costs and Sam responded with words to the effect that he thought it was all inclusive but to double-check with Maz.

184 Mr Hussein's affidavit included:

- 15 I refer to paragraph 26 of the Karim affidavit and paragraph 15 and 16 of the Sherif affidavit. I attended the opening of the Wetherill Park gym. Paul did not attend but Karim and Sherif did. I remember speaking to Sheriff and Karim after the tour of the gym and the workout. They were very enthusiastic in their praise for the look of the gym. I remember Karim asking if the fitout cost included all the equipment. I said words to the effect "No, the fitout cost

doesn't include the life fitness equipment. It will be an operating lease with Life Fitness so it is an operational expense. This is what we have done". ...

185 In cross-examination, Mr K Girgis denied that Mr Hussein said the words: "The fit-out cost doesn't include the Life Fitness equipment. It will be an operating lease with Life Fitness" – see: T143.38.

186 Mr S Girgis gave the following evidence (at T223.46 – 224.8):

Now, I'm going to – and while you were at the Wetherill Park gym in Sydney on 10 December 2016, Mr Hussein said to you and your brother words to the following effect. He said, "The fit-out cost doesn't include the Life Fitness equipment. It will be an operating lease with Life Fitness, so it is not an operational expense." That's the case, isn't it?---Yes. I believe so. But an operational expense and fit-out costs or start-up cost are two different things.

Well, can we – I'm just dealing first with what Mr Hussein said to you?---No problem.

Do you accept that he said words to that effect to you at the Wetherill Park gym on 10 December 2016?---Yes.

187 A difficulty with the first question set out above was that two sentences of what Mr Hagemrad allegedly said were put to Mr S Girgis at once. I considered from the manner in which Mr S Girgis answered the first question that Mr S Girgis agreed that Mr Hussein had stated that the Life Fitness equipment was not included in fit-out. I was left in some doubt that Mr S Girgis intended to agree that Mr Hussein had stated that the Life Fitness equipment would be an operational expense.

188 In his first affidavit, Mr Hagemrad stated:

19 During this period [being around June 2016], UFG was continuing to develop commercial arrangements with potential suppliers of services and equipment suppliers. One such potential supplier was Life Fitness Australia, the Australian distributor of various well-known brands of gym and fitness equipment. On 24 June 2016 I met Aaron Oman of Life Fitness at the premises in Wetherill Park Sydney where the first UFG gym was to be located. Following that visit, I received an email from Mr Oman, a copy of which is at Tab 7 of Exhibit annexed and marked MH-1.

...

25 I refer to paragraphs 27 and 28 of the Karim affidavit. I recall various conversations with Karim and Sherif during their visit about the quality of the Wetherill Park gym. I also recall that there was a discussion about the costs for the opening, including the costs required to run the presale, in particular wages, casual leasing and marketing costs. I deny saying "the equipment is already accounted for in the initial costs estimate in the disclosure document". The Wetherill Park gym equipment was obtained from Life Fitness Australia under an equipment lease as a result of the discussions referred to in paragraph 19 above. I recall Sam saying words to the effect: "the strength and cardio equipment are on an operating lease, and are therefore operating costs not a

capital cost". I have always told each prospective UFC franchisees that strength and cardio equipment should be obtained via operating leases as opposed to being purchased upfront.

189 The email dated 24 June 2016 to which Mr Hagemrad referred at [19] of his affidavit has been referred to earlier: see [146]. The email attached an invoice or “proposal” related to the Wetherill Park gym. The proposal contemplated that the Life Fitness equipment would be the subject of a 52 month “lease” after which the equipment “transfers to the client”. The proposal was in a total amount of \$317,416, inclusive of GST. The proposal contemplated 48 monthly repayments of \$6,933.81, with a 4 month break in payments after the first payment, before resuming with the next 47 payments (hence a 52 month lease).

190 In his second affidavit, Mr K Girgis stated:

13 I deny paragraph 25 [of Mr Hagemrad’s affidavit]. We did not discuss presale wages, casual leasing or marketing. Sam did not say the words alleged. I had asked Sam when he was taking us for a tour. Maz was not present when Sam was asked about the Life Fitness Equipment.

191 Mr Hagemrad denied saying that the equipment is already accounted for in the initial cost estimate in the disclosure document: T478.

192 I conclude that:

- (a) on 10 December 2016, Mr Hussein said to Mr K Girgis and Mr S Girgis that he thought the Life Fitness equipment was already included in the amounts previously disclosed – see further: at [245] and [246] below; and
- (b) shortly after, Mr Hagemrad said that the equipment was already accounted for in the initial cost estimate in the disclosure document – see further: at [247] and [248] below.

### ***9 and 10 January 2017: Emails***

193 On 9 January 2017, Mr S Girgis wrote an email to Mr Hagemrad and Mr Hussein, copied to Mr K Girgis and Mr Chau, stating that “[w]e have now had the opportunity to review the franchise agreement in detail and would like to clarify some of the clauses and discuss the fee structure”. A word document was attached to the email. This raised a number of issues and questions. The document concluded with the following questions:

Now that Wetherill Park is operational can we work out a more accurate cashflow and start up a cost calculation. From discussions with your team, fitout now appears to be closer to 800k. Can you advise the allocation of these costs?

With the cashflow you will now have a better understanding of revenue, member numbers, wages, and merchandise requirements.

194 Mr Hagemrad responded by email on 10 January 2017 sent to Mr S Girgis and Mr Hussein, copied to Mr K Girgis and Mr Chau. His email attached a word document which responded to the various matters which had been raised. Underneath the first paragraph set out above, the following annotation appeared:

The cost breakdown is approximately as follows \$200,000 W/P/D [Weights/Plates/Dumbbells], soft goods, UFC specific equipment incl Bag [r]ack, Octagon, Everest.

\$500,000 - \$600,000 fitout, fixtures, fittings, signage, branding, etc.

195 There was no response to the final paragraph of the word document which Mr S Girgis had sent. In particular, there was no statement about cash flow or revenue.

***29 to 31 January 2017: Decision to proceed and request for more information***

196 On 29 January 2017, Mr S Girgis responded to Mr Hagemrad's email of 10 January 2017. He stated:

Hi Maz,

Sorry for the late reply and thank you for your responses.

We have decided we want to proceed and we will be meeting Tomorrow to finalise things and sign the franchise agreement.

In the meantime can you get us an updated cash flow so we can work our numbers out?

...

197 Mr Hagemrad responded on 30 January 2017, attaching a (blank) cash flow template.

198 Mr Chau responded on 30 January 2017, stating:

Hi Maz

Thanks for sending through the template. We actually have this document already and have completed it and returned to you guys. We would now like to see if the figures we used are accurate as now that witherall [sic] park is operational.

Can you please give me an indication of the amount paid in wages and to coaches and pts [personal trainers] etc

Also have the June training dates been determined and can you advise the dates so we can plan flights etc

I'm planning to come to Sydney in March so will catch you guys then

199 On 30 January 2017, Mr Hagemrad responded to Mr Chau stating:

Hi Paul,

Thanks for your email.



Having a once over your previous cashflow, it appears to be in line with current expenses at the newly operating club in Western Sydney.

The labor cost is within the range, the only change I would suggest would be to increase the rent expense by 30% for the sake of conservativeness.

200 Mr Hagemrad's response could not be correct to the extent that it stated that the Updated Cash Flow which had been sent by the Balcatta applicants was "in line with current expenses at the newly operating club in Western Sydney" because the Updated Cash Flow did not take into account monthly expenditure for the lease of Life Fitness equipment. This was a significant additional expense.

***9 to 15 February 2017: Second Disclosure Document and draft franchise agreement***

201 On 9 February 2017, UFG's solicitors forwarded to Solomon Brothers, the Balcatta Franchisee's previous solicitors, a letter dated 9 February 2017, a disclosure document dated 31 October 2016 (**Second Disclosure Document**) and a second draft franchise agreement.

202 On 15 February 2017 HWL Ebsworth, UFG's solicitors, forwarded to Trinix Lawyers, the Balcatta Franchisee's new solicitors, a letter dated 15 February 2017, the Second Disclosure Document and the second draft franchise agreement. This email also attached the letter from UFG's solicitors to Solomon Brothers of 1 July 2016 which itself had the first draft franchise agreement and First Disclosure Document attached. The letter of 15 February 2017 stated that there was a new disclosure document, dated 31 October 2016. The letter provided a list of what were said to be the material information that had been updated when compared to the original disclosure document, namely the First Disclosure Document. Notably absent from the list was any reference to any increase to the expenditures mentioned in Schedule 5. As noted earlier, the upper and lower limits for equipment and fit-out had been significantly increased. As is referred to further below, the Second Disclosure Document was not read by Mr K Girgis, Mr S Girgis or Mr Chau.

203 On 15 February 2017, Mr Hagemrad forwarded to Mr K Girgis, Mr S Girgis and Mr Chau the email of 15 February 2017 which had been sent from HWL Ebsworth to Trinix Lawyers.

204 Clauses 14.3 to 14.5 of the Second Disclosure Document were the same as in the First Disclosure Document, addressing establishment costs, including the upper and lower limits of costs which could not easily be worked out.

205 Tables 1 in Schedule 5 now provided total establishment costs of \$653,500 to \$1,031,000 plus certain identified costs for which no specific amount was indicated. Table 1 provided:

**Table 1: Establishment Costs (Items 14.3, 14.4 and 14.5)**

Expenditures	Description of payment	Amount of the payment or the formula used to work out the payment	To whom the payment is made	When the payment is due	Whether refundable; if so, undue what circumstances
(a) Real property (including property type, location, and building size)	Leasing up front costs including your legal costs of reviewing lease and the like.	\$3,000 - \$5,000	Your solicitor and other third party suppliers	around the time of signing lease	Not refundable
	Costs of applying for development approval from the local council, if required	Will vary depending on site, Council and zoning	Your town planner	As required by town planner	Not refundable
(b) Equipment, fixtures, other fixed assets	Lease or purchase of equipment	\$300,000 - \$500,000	Franchisor, Various other suppliers	Prior to opening and upon purchasing.	Not refundable
(c) construction, remodelling, leasehold investments, decorating costs	Building, construction and fitout costs.	\$300,000 - \$450,000	Franchisor and Various contractors	Prior to opening during building stage.	Not refundable
(d) Inventory required to begin operation	Merchandise, Drinks and supplies	\$8,000 - \$12,000	Franchisor	Prior to opening	Not refundable
(d) Security deposits, utility deposits, business licences, insurance and other prepaid expenses	Deposits for Electricity, Insurance etc	Varies based on supplier	Your preferred supplier	Prior to opening	Yes
(e) Additional funds (including working capital, required by the franchisee before operations begin)	Required capital to maintain the business operations	\$40,000 - \$60,000	Third Parties	As incurred	Not refundable
(f) Other payments by a franchisee to begin operations	Travel expenses for training, Pre-opening advertising	\$2,500 - \$4,000	Third parties	Prior to opening	Not refundable

206 In cross-examination, Mr K Girgis gave evidence to the effect that, at the relevant time, he did not know there was an updated or Second Disclosure Document which had been provided. It was put to Mr K Girgis that the reason he did not read the Second Disclosure Document was

because he, Mr S Girgis and Mr Chau had done their own due diligence. The following evidence was given:

Now, you said that you now know – I think you just said a little earlier ago, as in a few seconds ago, that you now know that there is a disclosure document dated October 2016?---Yes.

Do I take it from that that, when you signed the franchise agreement in February 2017, you were not aware that there had been an updated disclosure document?---That's correct.

Do you accept that the documents which Mr Girgis – I'm sorry. Do you accept that the documents which Mr Hagemrad sent to you in February 2017 contained a disclosure document dated October 2016?---Yes.

Can I ask you to go to page 44. I'm sorry. Can I ask you to go to page 4382 of volume 5?---Yes.

And you can see that, in table 1, schedule 5 of the October disclosure document, that there are different figures for equipment and construction to those set out in the March disclosure document. Do you accept that?---Yes.

What I want to put to you is this, Mr Girgis. By February 2017, you had carried out due diligence in relation to becoming a UFC franchisee. Do you agree with that?---Yes.

And, as part of that due diligence, you made inquiries and investigations in relation to the costs which would be incurred in setting up the business; correct?---Yes.

And part of those inquiries – I withdraw that. Part of that due diligence involved you, your brother and Mr Chau drawing on your experience of setting up gyms in Perth; correct?---Partly, yes.

The reason why – the reason, Mr Girgis, why you did not concern yourself with the updated disclosure document in February 2017 is because, by February 2017, you had made your own assessment of what the likely start-up costs for a UFC franchise business would be. That's the case, isn't it?---No, it's not.

207 I accept this evidence.

208 Mr S Girgis could not recall whether or not he read the Second Disclosure Document: T225. It is unlikely that Mr S Girgis read the Second Disclosure Document. This conclusion is supported by the lack of reference to it in the "Franchisee Certificate" addressed further below. Further, if he had, he would surely have noticed and remembered the increased amounts in Table 1 of Schedule 5.

209 Mr Chau stated that he recalled that an updated disclosure document had been given, but he did not read it. He gave the following evidence at T304:

Do you recall knowing, in February 2017, that an updated disclosure document had been provided?---Yes.

And if you go to page 4382, you can see there schedule 5 of the updated disclosure document, correct?---Yes.

Do you recall reading this material in about February 2017?---No, I didn't. I believe this document came the day of signing, and our lawyers reviewed what was actually changed as what was written on the letters – what the lawyer said was changed on the letter that accompanied the document. So I didn't look through the entire document, as it wasn't listed as being changed.

Well, you were able to work out, weren't you, Mr Chau, that it was an updated disclosure document?---Yes, correct.

And if you wanted the opportunity to read it, there was nothing to prevent you from taking that opportunity. Do you accept that?---I believe time was a factor – that there was a deadline, and it had to be back that day. I believe we signed it that day – the franchise agreement, or maybe the day after. I – so our lawyers looked at – it went to our lawyers; they looked at the changes that were listed, and there was nothing significant.

210 In re-examination, M Chau confirmed that the letter he was referring to was the letter from HWL Ebsworth to Trinix Lawyers which did not refer to any changes to Schedule 5 when itemising the main changes to the Second Disclosure Document. I accept Mr Chau's evidence.

211 Mr K Girgis was cross-examined about cl 32.8 in the franchise agreement, detailed above at [166]. He agreed that he was aware that he had an obligation to act in good faith and agreed that he had a brief look over the Franchising **Code** of Conduct contained in the Competition and Consumer (Industry Codes – Franchising) Regulation 2014. A copy of the Code was enclosed in the letter from UFG's solicitors dated 1 July 2016. Mr K Girgis agreed that both he and UFG had an obligation to act honestly and fairly: T121. Mr K Girgis stated he had not read cl 32.8 of the Franchise Agreement. I accept that evidence.

212 Mr Chau did not recall reading cl 32.8 and stated that his lawyers had not brought it up either: T293.27. His evidence at T294.1 included:

And the reason why – prior to signing the franchise agreement, the reason why you did not notify UFG of any cashflow representations as required by clause 32.8 is because by the time you signed the franchise agreement, you weren't relying on any cashflow representations which had been made by UFG. That's the case, isn't it?---No, we were definitely relying on those figures because we hadn't – we had no idea as to how this business would be.

213 In re-examination, Mr Chau confirmed he never saw a "Prior Representations Deed" as referred to in cl 32.8, and was not asked by UFG to sign any such document: T306. I accept Mr Chau's evidence.

214 On 15 February 2017, Mr Chau and Mr K Girgis signed a “Franchisee Certificate” required by cl 10 of the Code. This contained a number of “statements” required by cl 10. Statements 1 to 3 of Part 1 were as follows:

#### FRANCHISEE CERTIFICATE

##### Statements required by clause 10 of the Franchising Code of Conduct (Code)

Girchow Enterprises Pty Ltd ACN 613 250 454 (the <b>Prospective Franchisee</b> ) and Karim Girgis, Sherif Elhamy Wadie Girgis and Paul Chau (the <b>Guarantors</b> ) (collectively referred to as <b>We</b> in this certificate) hereby certify and make the following statements to Ultimate Franchising Group Pty Ltd (the <b>Franchisor</b> ) that:	
<b>Part 1: Clause 10(1) Statements - Acknowledging receipt of disclosure document and Code</b>	
<i>You must complete Statements 1,2 and 3 below:</i>	
	<b>(*Tick applicable box)</b>
<b>Statement 1:</b> We completed and provided this certificate to the Franchisor BEFORE entering into the franchise agreement.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
<b>Statement 2:</b> We received, read and have had a reasonable opportunity to understand the disclosure document, the Code, the franchise agreement, machinery deed (if any) (the <b>Franchise Documentation</b> ) before we signed this Certificate.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
<b>Statement 3:</b> We received the disclosure document on the following date:	31/07/2016 2016

215 “Statement 3” reveals that the relevant disclosure document which the signatories confirmed they had received was the disclosure document received on 1 July 2016, namely the First Disclosure Document, dated 31 March 2016.

216 The “Franchisee Certificate” also confirmed that they had obtained legal advice and that they had had a reasonable opportunity to understand the disclosure document and the franchise agreement.

217 Mr S Girgis signed a certificate to the same effect on 28 February 2017. The first part of this document was as follows:

FRANCHISEE CERTIFICATE	
Statements required by clause 10 of the Franchising Code of Conduct (Code)	
Girchow Enterprises Pty Ltd ACN 613 250 454 (the <b>Prospective Franchisee</b> ) and Karim Girgis, Sherif Elhamy Wadie Girgis and Paul Chau (the <b>Guarantors</b> ) (collectively referred to as <b>We</b> in this certificate) hereby certify and make the following statements to Ultimate Franchising Group Pty Ltd (the <b>Franchisor</b> ) that:	
<b>Part 1: Clause 10(1) Statements - Acknowledging receipt of disclosure document and Code</b>	
<b>You must complete Statements 1,2 and 3 below:</b>	
	<b>(*Tick applicable box)</b>
<b>Statement 1:</b> We completed and provided this certificate to the Franchisor BEFORE entering into the franchise agreement.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
<b>Statement 2:</b> We received, read and have had a reasonable opportunity to understand the disclosure document, the Code, the franchise agreement, machinery deed (if any) (the <b>Franchise Documentation</b> ) before we signed this Certificate.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
<b>Statement 3:</b> We received the disclosure document on the following date:	1 / 1 / 7 / 2016

218 Again, “Statement 3” shows that the relevant disclosure document which Mr S Girgis confirmed he had received was the First Disclosure Document. The “Franchisee Certificate” confirmed that Mr S Girgis had obtained legal advice and that he had had a reasonable opportunity to understand the First Disclosure Document and the franchise agreement.

219 Mr Chau, Mr K Girgis and Mr S Girgis signed the Balcatta Franchise Agreement on or about 15 February 2017. They did so without having read the Second Disclosure Document.

### 28 and 29 March 2017: Emails

220 On 28 March 2017, Mr Chau sent an email to Mr Hagemrad, Mr K Girgis and Mr S Girgis containing the following:

Hi Maz

I just wanted to confirm with you what is the anticipated investment required to start up the gym, I understand that we can't be certain as each site differs but from my understanding from our previous discussion we have always discussed a figure of approx. 800k total.

I spoke to Jason today and he tells me it's more like 1.2M and that the 800k does not include the cost of the life fitness gym equipment. I have always been under the impression that 800k was the total investment inclusive of all equipment.

Can you please confirm

221 Mr Hagemrad responded by email on 28 March 2017 stating:

Hi Paul,

At all times including the most recent visit by Sherif and Karim the invested was purported [to] fall within \$700K to \$900k plus GST. This figure is a best guess and is based on numerous variables and unknowns. The Life Fitness equipment has always been discussed as an operating lease and not a capital expenditure. I was present when the guys were discussing the numbers with Sam on site at Wetherill Park and the Life Fitness equipment was always reported to be on an operating lease.

In this instance the total investment remains in the vicinity of \$700-\$900 plus GST.

I hope this clarifies it for you.

222 Mr Chau responded by email on 29 March 2017, stating:

Thanks Maz for the confirmation

Any info you can provide me about the life fitness financing deal would be great so I can see what is required

### **Representations**

223 Issue 1 of the parties' agreed list of issues concerned the Balcatta Franchise. It was whether Mr Hagemrad and Mr Husseinini made representations to Mr K Girgis, Mr S Girgis and Mr Chau to the effect that:

- (a) franchisees for UFC gyms would be able to be established for start-up costs in the range of \$500,000 to \$800,000: Second Amended Statement of Claim (**2FASOC**) [10], [12];
- (b) gross annual income for the Balcatta gym would be \$1,152,000: 2FASOC [14(a)];
- (c) gross profit would be \$1,057,536 based on retail cost of goods sold of \$4,800 monthly, advertising of 2% and royalties of 10%: 2FASOC [14(b)];
- (d) establishment costs for the lease or purchase of equipment would be \$250,000 to \$350,000: 2FASOC [17(e)], [25];
- (e) establishment costs for building, construction and fit-out costs would be \$190,000 to \$360,000, approximately \$300 per square metre: 2FASOC [17(f)];
- (f) as at 16 July 2016, preferential arrangements were in place with suppliers, including for the fit-out of the premises: 2FASOC [20(a)];
- (g) establishment costs for Balcatta would be \$500,000 to \$600,000, for a gym of 1000 square metres: 2FASOC [20(b)], [20(c)], [23(b)], [26(b)], [27].

224 These representations may be grouped into two kinds:

- “income representations”: Issue 1(b) and (c); and
- “establishment costs representations”: Issue 1(a) and (d) to (g).

***The income representations: Issue 1(b) and (c)***

225 The 2FASOC pleaded at [13] and [14]:

13 In or about May 2016 Maz Hagemrad provided by email a draft business plan and cashflow forecast to Karim Girgis.

14 The cashflow forecast was in the form of an Excel worksheet, titled "12 Month Cash Flow Worksheet" which forecast that:

(a) gross income would be \$96,000 monthly or \$1,152,000 annually, based on a forecast of 800 members paying \$30 weekly; and

(b) gross profit would be \$88,128 monthly or \$1,057,536 based on retail cost of goods sold of \$4,800 monthly, advertising of 2% and royalties of 10%.

226 Mr Hagemrad and Mr Husseinini disputed that they provided a draft business plan and cash flow forecast to Mr K Girgis in May 2016. I accept that they did not provide such documents. What was provided were templates which were later populated by Mr K Girgis, Mr S Girgis and Mr Chau.

227 In the Draft Cash Flow which they prepared using the Cash Flow Template which had been provided to them, Mr K Girgis, Mr S Girgis and Mr Chau decided to use a monthly income of \$96,000, commencing in May 2017. This was calculated by assuming premises of 1000 square metres, a membership of 800 and weekly fees of \$30. Calculated over the year this gave an annual gross income of \$1,152,000. This was sent to Mr Hagemrad on 9 June 2016. It was discussed at the Second Skype Meeting on 15 June 2016. One assumption that was used in preparing it was that the membership could be forecast as one person per square metre. It is likely that Mr Hagemrad communicated this "rule of thumb", but not in terms which represented anything more than what one could use as a working hypothesis and not as something which could be guaranteed or necessarily even likely. I think it likely that Mr Chau and Mr Hagemrad discussed using 80% and that Mr Hagemrad expressed a view that he considered that a reasonable figure to use.

228 With respect to 2FASOC[13], the allegation is not made out.

229 With respect to 2FASOC [14(a)], neither Mr Hagemrad nor Mr Husseinini represented that gross annual income for the gym would or was likely to be \$1,152,000.

230 With respect to 2FASOC [14(b)], neither Mr Hagemrad nor Mr Husseinini represented that gross profit would or was likely to be \$1,057,536 based on retail cost of goods sold of \$4,800 per month, advertising of 2% and royalties of 10%.



***The establishment costs representations***

***Issue 1(a): 2FASOC [10], [12]***

231 The 2FASOC pleaded at [8], [10], [11] and [12]:

8 On 19 January 2016 the UFG Franchisor held a presentation evening to promote the UFG Gym franchise, which was held at the Hyatt Regency Hotel Perth.

...

10 During the presentation, and in answer to questions from Karim Girgis, Maz Hagemrad and Sam Hussein made oral representations to the effect:

- (a) franchises for UFC Gym would be able to be established for startup costs in the range of \$500,000 to \$800,000;
- (b) the projected figures of \$500,000 to \$800,000 would be inclusive of all equipment and fit-out costs.

11 On 13 April 2016 at approximately 2 pm Australian Western Standard Time there was a Skype meeting between Karim Girgis, Maz Hagemrad and Sam Hussein.

12 During this Skype meeting, Maz Hagemrad and Sam Hussein made oral representations to the effect:

- (a) they confirmed that franchises for UFC Gym would be able to be established for startup costs in the range of \$500,000 to \$800,000;
- (b) the range of projected startup costs was based on the size of the premises, with larger premises being at the higher end of the range.

232 As to 2FASOC [10], I consider it likely that, when giving his presentation, Mr Hagemrad gave estimates consistent with the slide presentation. It is likely that he spoke to Slide 66. That slide referred to a “total initial investment” of \$390,000 to \$550,000; “working capital” equal to 3 months; and a franchise fee of \$60,000.

233 It is likely that, after the formal presentation, Mr K Girgis would have asked what the total start-up costs would be and, in particular, whether the total start-up costs included fit-out and equipment, consistently with his evidence to that effect. This was an obvious and likely question to ask for someone with experience in gyms and as a person considering pursuing the franchise opportunity.

234 It is unlikely that Mr K Girgis’s question would not have been answered by Mr Hagemrad. The whole point of the Hyatt presentation was to provide information to prospective franchisees and to interest people in taking up a franchise.

235 On balance, I accept that Mr Hagemrad represented that a UFC Gym was likely to be able to be established for start-up costs in the range of \$500,000 to \$800,000. In context, the start-up costs were intended and understood to include fit-out, all equipment, working capital and the franchise fee of \$60,000.

236 It follows that I accept that the representations pleaded in 2FASOC [10(a)] and [10(b)] were both made. The respondents submitted that the words “would be” in 2FASOC were intended to convey a guarantee about what was going to happen as a matter of fact. I reject that submission. The words “would be” in the 2FASOC are used in the sense of signifying what is likely to be the situation in the future.

237 As to 2FASOC [12], I accept that Mr Hagemrad represented at the Skype meeting that the start-up costs were likely to be between \$500,000 and \$800,000. In the context of the Hyatt presentation, and Slide 66 in particular, the reference to start-up costs was a reference to the cost of fit-out and the cost of all equipment, working capital and the franchise fee of \$60,000 and would have been so understood by all participants.

*Issue 1(d): 2FASOC [17(e)], [24], [25]*

238 The 2FASOC included:

17 The Disclosure Document [dated 31 March 2016] stated:

...

(e) at Table 1 of Schedule 5, row (b), establishment costs for the lease or purchase of equipment would be \$250,000 to \$350,000;

...

24 On 10 December 2016 Karim Girgis and Sherif Girgis attended a tour of the Wetherill Park gym, during which tour he asked Sam Hussein[i] about the cost of the Life Fitness equipment, to which Sam Hussein[i] responded to the effect that the Life Fitness equipment was included in the costs in the Disclosure Document.

25 Following this tour, Karim Girgis asked Maz Hagemrad about the costs of the Life Fitness equipment, to which Maz Hagemrad responded to the effect that the Life Fitness equipment was included in the costs in the Disclosure Document.

239 As to 2FASOC [17(e)], the First Disclosure Document, which was dated 31 March 2016 but communicated to the Balcatta applicants on 1 July 2016, stated in relation to expenditure for “Equipment, fixtures, other fixed assets” the amounts “\$250,000 - \$350,000” in the column

entitled “Amount of the payment or the formula used to work out the payment”, describing the payment as “lease or purchase of equipment”.

240 It is not clear whether the amounts of \$250,000 to \$350,000 were GST inclusive or exclusive. Tables 2 and 3 are expressed to state amounts “exclusive of GST” and Table 2 also (unnecessarily) states “plus GST” in relation each expense. Table 1 does not state that the prices are exclusive of GST or state in relation to any amount that it is “plus GST”. On balance, Table 1 would most likely have been understood as stating prices on a GST exclusive basis.

241 I conclude that the First Disclosure Document represented that the total cost for equipment required to open and operate a UFC Gym, whether that equipment was leased or purchased, was likely to be in the range of between \$250,000 to \$350,000, excluding GST, these being the lower and upper limits in the range.

242 The First Disclosure Document was signed by Mr Hussein and the figures in it were prepared by Mr Hagemrad. Both of them made the representations contained in it and, through them, UFG made the representation.

243 As to 2FASOC [24] and [25], there was no dispute between the parties that Mr K Girgis asked Mr Hussein about the Life Fitness equipment during the tour of the Wetherill Park Gym on 10 December 2016.

244 Mr K Girgis’s evidence was that he had asked whether “the cardio and resistance equipment” (which was a reference to the Life Fitness equipment) was included in the start-up cost estimate and that Mr Hussein had answered that he was “pretty sure it’s all included in the costs we’ve sent through, but you should check with Maz”.

245 Mr Hussein’s evidence was that Mr K Girgis had asked if the fit-out cost included all the equipment and that he had responded: “No, the fit-out cost doesn’t include the Life Fitness equipment” and that it would “be an operating lease with Life Fitness so it is an operational expense”. Mr Hussein did not specifically deny stating that he was “pretty sure it’s all included in the costs we’ve sent through, but you should check with Maz”.

246 As to 2FASOC [24], I accept Mr K Girgis’s evidence that he asked Mr Hussein whether “the cardio and resistance equipment” (being the Life Fitness equipment) was included in the start-up cost. I accept that Mr Hussein said he was “pretty sure it’s all included in the costs we’ve sent through, but you should check with Maz”.

247 Mr K Girgis’s evidence was that he spoke to Mr Hagemrad after the tour and asked whether the cost of the cardio and resistance equipment was included in the start-up costs to which Mr Hagemrad responded: “The equipment is already accounted for in the initial cost estimate in the disclosure document”. Mr Hagemrad denied this: T478.23.

248 As to 2FASOC [25], I accept that Mr K Girgis spoke to Mr Hagemrad after the Wetherill Park tour. I conclude that Mr K Girgis asked Mr Hagemrad whether the cost of the cardio and resistance equipment (which both would have understood to be a reference to the Life Fitness equipment) was included in the start-up costs and that Mr Hagemrad responded to the effect that “the equipment is already accounted for in the initial cost estimate in the disclosure document”. This conclusion is supported by the following:

- (1) It is consistent with Table 1 of Schedule 5 of the First and Second Disclosure Documents which referred to the “lease or purchase of equipment”. Objectively assessed, paragraph (b) of Table 1 in Schedule 5 of the disclosure documents was intended to refer to all equipment, including the Life Fitness equipment.
- (2) If paragraph (b) of Table 1 was not inclusive of Life Fitness equipment then the expense should have been included in the disclosure documents as a recurring expense in Table 2 or 3 of Schedule 5. It was not. This would have been such a significant omission in Table 2 or 3 that it is unlikely that it was not intended to be in Table 1.
- (3) In the Second Disclosure Document, the relevant item had been increased from a range of \$250,000 to \$300,000 (in the First Disclosure Document) to a range of \$300,000 to \$500,000. The amount of \$500,000 could only make sense if it included the Life Fitness equipment. None of the contemporaneous documents supported a conclusion that, as at 31 October 2016, being the date of the Second Disclosure Document, the cost of the equipment excluding the Life Fitness equipment was as high as \$300,000 to \$500,000. In his email of 10 January 2017, Mr Hagemrad stated that the cost of the equipment for Wetherill Park identified in that email – which was essentially a reference to UFC Branded equipment and which did not include Life Fitness equipment – was about \$200,000. Mr Hagemrad knew the approximate cost of non-Life Fitness equipment as at 31 October 2016 as a result of various quotations and invoices received in relation to Wetherill Park and otherwise.
- (4) The conclusion is consistent with the disclosure documents in respect of the Blacktown and Castle Hill franchises, discussed later.

- (5) The conclusion is consistent with a disclosure document dated 30 October 2021 which expressly states in relation to paragraph (b) of Table 1 in Schedule 5 that one of the entities to which payment is to be made is Life Fitness: Exhibit 19. In that disclosure document, the total cost for “lease or purchase of equipment” in Table 1 of Schedule 5 is identified as \$600,000 to \$800,000.

*Issue 1(e): 2FASOC [17(f)]*

249 The 2FASOC included:

17 The Disclosure Document [dated 1 March 2016] stated:

...

- (f) at Table 1 of Schedule 5, row (c), establishment costs for building, construction and fit-out costs would be \$190,000 to \$360,000, and that such costs would be approximately \$300 per square metre;

250 The First Disclosure Document stated in relation to “construction, remodelling, leasehold improvements, decorating costs” the amounts “\$190,000 - \$360,000 (approx. \$300 psm)” in the column entitled “Amount of the payment or the formula used to work out the payment”, being described as payments for “building, construction and fitout costs”. As mentioned, the representations in the First Disclosure Document were made by both Mr Hussein and Mr Hagemrad and, through them, UFG.

*Issue 1(f): 2FASOC [20(a)]*

251 The 2FASOC included:

18 On 12 July 2016 Paul Chau sent an email to Maz Hagemrad which stated:

I know that it had been estimated that we will require about 500 - 600k to start up the gym but just wondering if you have anymore detail you can provide us on this.

The costs which I am would like some clarification on is fitout. I guess you guys will be working off the fitout guide to determine a rough estimate so wondering if there has been some quotes received to come up with that figure?. If there has been can you break it down for us such as flooring, plumbing, lighting, AC etc.

I just want to make sure we budget sufficient funds for the project. To start up a Jetts gym of 300 - 400 sqm cost about 500 - 600k which is why I[']m a bit skeptical [sic] to how a 1000sqm gym would cost similar considering the cost of equipment for both business are similar (approx 250k - 300k)

19 On 16 July 2016 Maz Hagemrad responded [to] an email to the Balcatta Guarantors, copy to Sam Hussein, which stated:

At this stage our indicatives are a best guess scenario based on our preferential agreements with suppliers. The budgeting ranges are as follows, please note these remain indicative and are subject to final quotations for each individual site:

- Fit out: \$220 - \$280 psm
- Flooring (supply and Install) \$60 - \$80 psm
- AV: \$15 - \$25 psm

All other fitout costs are factored into the 'Fitout' item line above including plumbing, electrical, lighting etc.

20 This 16 July 2016 email contained representations to the effect that:

- (a) preferential arrangements were in place with suppliers, including for the fit-out of the premises;

...

252 Mr Hagemrad denied that the representation in [20(a)] was conveyed.

253 The 16 July 2016 email conveyed a representation that UFG had at least some “preferential agreements” with suppliers which would benefit the franchisees. It is not clear what those preferential agreements were. In the context that the representation was made in estimating likely future costs of fit-out, the representation also conveyed that there were likely to be preferential agreements with suppliers at the time the Balcatta applicants were likely to carry out their fit-out.

*Issue 1(g): 2FASOC [20(b)], [20(c)], [23(b)], [26(b)], [27]*

254 As mentioned, Issue 1(g) was expressed to be whether Mr Hagemrad and Mr Hussein made a representation to the effect that establishment costs for the Balcatta Franchise would be \$500,000 to \$600,000, for a gym of 1000 square metres. The issue expressed in this way does not fully reflect the pleaded issues. The 2FASOC included:

20 This 16 July 2016 email contained representations to the effect that:

...

- (b) the startup costs would be \$500,000 to \$600,000, notwithstanding that the area of the proposed Balcatta UFG Gym would be 1000 square metres;
- (c) the fit-out costs would be \$220 to \$280 per square metre, plus \$60 to \$80 per square metre for supply and installation of flooring, and audio-visual of \$15 to \$25 per square metre.

...

22 On 23 September 2016 Maz Hagemrad responded an email to the Balcatta Guarantors, which stated:

We are full steam ahead now with the first franchise model club due to open early November.

As for costings they are per our original estimations.

23 This 23 September 2016 email contained representations to the effect that:

- (a) there was a UFG Gym franchise due to open in early November (which the Balcatta franchisors understood to be Wetherill Park, Sydney);
- (b) the fit-out costs for that franchise were consistent with the above representations of fit-out costs namely from \$500,000 to \$600,000.

...

26 On 10 January 2017 Maz Hagemrad sent an email to the Balcatta Guarantors, attaching a document responding to questions, which document represented that:

- (a) the cost breakdown would be approximately \$200,000 for soft furnishings, UFC Gym specific equipment including bag racks, Octagon and Everest;
- (b) the cost for fitout, fixtures, fittings, signage and branding would be \$500,000 to \$600,000.

27 During various telephone conversations with the Balcatta Guarantors in the period July to December 2016 Maz Hagemrad made oral representations to the effect that the above income forecasts and/or the above establishment costs were correct.

255 As to 2FASOC [20(b)], Mr Hagemrad's email of 16 July 2016 did not expressly contradict what had been said in Mr Chau's email of 12 July 2016 to which it was a response. Mr Chau's email noted that Mr Hagemrad and he (Mr Chau) had been estimating total start-up costs of \$500,000 to \$600,000 and it noted that the cost of equipment for a Jetts gym of 300 – 400 square metres and a UFC gym of 1000 square metres were similar, being between \$250,000 and \$300,000.

256 The email of 16 July 2016 expressly represented that for a 1,000 square metre gym, the fit-out costs would be in the range of \$295,000 to \$385,000 (calculated by reference to the ranges given for "fit-out", "flooring" and "AV" in Mr Hagemrad's 16 July 2016 email).

257 In context, the email of 16 July 2016 also implicitly:

- accepted that all of the equipment required to establish the gym would cost between \$250,000 and \$300,000; and

- represented that total start-up costs for fit-out and all equipment was likely to be between \$545,000 and \$685,000.

258 As to 2FASOC [20(c)], it was not in dispute that the email contained a representation to the effect that the best guess scenario for fit-out costs (excluding “flooring” and “AV”) was in the range of \$220 to \$280 per square metre. However as noted immediately above, it contained a representation that the best guess scenario for total fit-out costs (including “flooring” and “AV”), for a 1,000 square metre premises, would be in the range of \$295,000 to \$385,000.

259 As to 2FASOC [23(b)], the 23 September 2016 email conveyed a representation that the “costings” for the Wetherill Park premises were likely to be as “per ... original estimations”. Assessed against the dealings and communications between the parties up to that point in time, the email represented that the start-up costs – comprising all fit-out and all equipment – were proving to be within the “original estimations”, namely within the range of \$500,000 to \$800,000 which had previously been discussed between the parties and which was not inconsistent with the First Disclosure Document.

260 As to 2FASOC [26(b)], the 10 January 2017 email attached a word document containing Mr Hagemrad’s answers to questions which the Balcatta applicants had asked. The relevant part was as follows (the italicised portion indicates Mr Hagemrad’s response) :

Now that Wetherill Park is operational can we work out a more accurate cashflow and start up a [sic] cost calculation. From discussions with your team, fitout now appears to be closer to 800k. Can you advise the allocation of these costs?

*The cost breakdown is approximately as follows \$200,000 W/P/D [Weights, Plates, Dumbbells], soft goods, UFC specific equipment incl Bag [r]ack, Octagon, Everest.*

*\$500,000 - \$600,000 fitout, fixtures, fittings, signage, branding, etc.*

With the cashflow you will now have a better understanding of revenue, member numbers, wages, and merchandise requirements.

261 The question asked was, in substance, whether “start up” or “fitout” was proving to be closer to \$800,000. Assessed in the context of the dealings and communications between the parties to that point in time, the terms “start up” and “fitout” in the question was a reference to all fit-out and all equipment. That was evidently understood because Mr Hagemrad’s answer referred to both equipment and fit-out.

262 Mr Hagemrad’s response sent by the 10 January 2017 email represented that, in relation to Wetherill Park, the total “start up” or “fitout” costs (being all fit-out and all equipment) were \$800,000 and that those costs comprised:



- the cost of weights, plates and dumbbells, soft goods, UFC specific equipment including bag rack, Octagon and Everest was \$200,000; and
- the cost of fit out, fixtures, fittings, signage, branding etc was between \$500,000 and \$600,000.

263 In context, the 10 January 2017 email represented that those were also likely to be the relevant costs for the applicants to set up a UFC franchise conducted in premises of 1000 square metres.

264 As to 2FASOC [27], this allegation does not identify sufficiently clearly any other conduct conveying a representation for it to be addressed.

### **Reliance**

265 Issue 4 as identified by the parties was whether, to the extent the representations were made, the applicants relied on them in entering into the franchise agreements and guarantees.

### ***Income representations***

266 The question of reliance on the “income representations” does not strictly arise because I have concluded that they were not made: Issue 1(b) and (c).

267 Even if they had been made, I consider that Mr K Girgis, Mr S Girgis and Mr Chau did not rely upon Mr Hagemrad’s conduct (or silence) so far as concerns the pleaded income representations.

268 The income representations were founded upon the Draft Cash Flow and the Updated Cash Flow, being documents prepared by Mr K Girgis, Mr S Girgis and Mr Chau. They primarily relied on their own experience and calculations in reaching conclusions about income. They did not rely on any confirmation or approval of their calculations by Mr Hagemrad.

269 Mr K Girgis, Mr S Girgis and Mr Chau each knew that Mr Hagemrad had less experience than them in operating gyms. Each of them knew that no UFC gym had operated in Australia at the relevant time. Each of them appreciated that the gross income Mr K Girgis, Mr S Girgis and Mr Chau had forecast was only a forecast and that any number of events might transpire to affect that income being realised. In addition to experience in operating gyms, Mr Chau had significant financial analytics experience. Mr K Girgis’s evidence was that he considered the income projections which he had prepared with Mr S Girgis and Mr Chau to be “relatively accurate” by reference to his previous franchises: T123.

### ***Establishment costs representations***

270 In summary, the representations conveyed were:

- (1) Issue 1(a):
  - (a) on 19 January 2016, that a UFC gym was likely to be able to be established for start-up costs in the range of \$500,000 to \$800,000, such costs including fit-out, all equipment, working capital and the franchise fee of \$60,000;
  - (b) on 13 April 2016, that franchises for UFC gyms were likely to be able to be established for start-up costs in the range of \$500,000 to \$800,000, such costs including fit-out, all equipment, working capital and the franchise fee of \$60,000;
- (2) Issue 1(d):
  - (a) in the First Disclosure Document, that establishment costs for the “lease or purchase of equipment” were likely to be \$250,000 to \$350,000;
  - (b) on 10 December 2016 by Mr Hussein, that the Life Fitness equipment was included in the start-up costs previously sent through (in the First Disclosure Document);
  - (c) at some time shortly after 10 December 2016 by Mr Hagemrad, that the Life Fitness equipment was already accounted for in the initial cost estimate in the disclosure document;
- (3) Issue 1(e): in the First Disclosure Document, that establishment costs for “building, construction and fit-out costs” would be \$190,000 to \$360,000 or approximately \$300 per square metre;
- (4) Issue 1(f): on 16 July 2016, that UFG had “preferential agreements” with suppliers and that these were likely to be available when the Balcatta applicants established their franchise;
- (5) Issue 1(g):
  - (a) on 16 July 2016, that the figures which had been provided for total start-up costs were broadly correct in that the likely fit-out would be between \$295,000 and \$385,000 and all of the equipment would cost between \$250,000 and \$300,000 providing total start-up costs of between \$545,000 and \$685,000;

- (b) on 16 July 2016, that for a 1,000 square metre premises the best guess scenario was for:
- fit out costs in the range of \$220 to \$280 per square metre; and
  - total fit out costs (including “flooring” and “AV”) in the range of \$295,000 to \$385,000;
- (c) on 23 September 2016, that the “costings” for the Wetherill Park premises were as “per ... original estimations” meaning that the start-up costs – comprising fit-out and all equipment – were proving to be within the range of \$500,000 to \$800,000;
- (d) on 10 January 2017, that if the applicants were to open a UFC franchise in premises of 1000 square metres:
- the cost of weights, plates and dumbbells, soft goods, UFC specific equipment including bag rack, Octagon and Everest would be likely to be \$200,000; and
  - the cost of fit out, fixtures, fittings, signage, branding and such like was likely to be between \$500,000 and \$600,000.

*Issue 1(a)*

271 Any direct causative effect of representations made at the Hyatt presentation on 19 January 2016 and at the Skype meeting of 13 April 2016 about total establishment costs to the applicants entering into the franchise agreement and guarantees would have been diminished by later events. There was not any UFC franchise gym that had opened in Australia. UFG had not finally decided on equipment branding. The parties had many later communications based on information which later became available.

272 Notwithstanding, it is relevant that the highest figure mentioned for total establishment costs was \$800,000 and this number persisted in the communications between the parties, although the various integers which comprised the amount of \$800,000 altered over time. At the time of the Hyatt presentation, the amount of \$500,000 to \$800,000 included working capital and the franchise fee in addition to fit-out and all equipment. Later, the phrase “start-up costs” was being used to refer only to the fit-out and all equipment.

273 The representations made on 19 January 2016 and 13 April 2016 were relied on in the way identified at [314] below.

*Issue 1(d)*

274 The First Disclosure Document represented that “lease or purchase of equipment” would be in the range \$250,000 to \$350,000, those identifying the upper and lower limits of the range. Objectively, this refers to all equipment, whether leased or purchased, including the Life Fitness equipment. This is what Mr Hagemrad intended. It is what was understood.

275 The First Disclosure Document was received under cover of a letter dated 1 July 2016. Mr K Girgis, Mr S Girgis and Mr Chau read the First Disclosure Document in July 2016. Mr K Girgis and Mr Chau signed a franchisee certificate on 15 February 2017 and Mr S Girgis signed one on 28 February 2017. The franchisee certificates confirmed each of them had read the First Disclosure Document. The evidence is not clear about whether the First Disclosure Document was read a second time in February 2017.

276 As is discussed further below, I conclude that – at the time each entered into the franchise agreement and guarantees – Mr K Girgis and Mr Chau did not appreciate that the Life Fitness equipment at Wetherill Park was financed under a “lease” arrangement or treated as an operational expense.

277 As discussed further below, I conclude that – at the time each entered into the franchise agreement and guarantees – Mr K Girgis, Mr S Girgis and Mr Chau thought that the Life Fitness equipment was included in Table 1 of Schedule 5. This view was held because that is what the First Disclosure Document stated and that was consistent with the communications between the parties up until July 2016 when it was read.

*Issue 1(e)*

278 The First Disclosure Document represented that “building, construction and fit-out costs” were likely to be \$190,000 to \$360,000.

279 Whether or not the First Disclosure Document was read a second time in February 2017, at the time of entering into the franchise agreement and guarantee, reliance on the content of it would necessarily have been affected by the communications between the parties, particularly those which post-dated the First Disclosure Document having been read in July 2016.

280 At least after the 10 December 2017 email, Mr K Girgis, Mr S Girgis and Mr Chau were operating on the basis that the fit-out costs were likely to be higher than represented in the First Disclosure Document. As discussed further below – at the time each entered into the franchise

agreement and guarantees – the applicants are likely to have thought that fit-out would be around a maximum of \$600,000.

281 As discussed below, I accept that – at the time each entered into the franchise agreement and guarantees – each was making decisions on the basis that it was likely that the total cost of all fit-out and all equipment was likely to be around \$800,000. This understanding was contributed to by the terms of Table 1 of Schedule 5 of the First Disclosure Document.

*Issue 1(f)*

282 There was no specific evidence that the franchise agreement or guarantees were executed because of the representation that “preferential agreements” were or would be in place with suppliers. It is not clear from the 16 July 2016 email what the preferential agreements were or with whom. Notwithstanding, the representation would have provided comfort that the figures being given by Mr Hagemrad were likely to be achieved because preferential agreements were in place that would benefit franchisees. That is plainly what Mr Hagemrad intended to convey by making the representation.

283 I have referred earlier to Mr K Girgis’s evidence in cross-examination when he stated that he understood that what was provided was a range and that “they had preferential agreements that they were working on, so it was getting close”.

*Issue 1(g)*

284 As discussed further below, the 16 July 2016 and 23 September 2016 emails were relied on in the sense that they were part of a broadly consistent narrative about the level of establishment costs for fit-out and equipment totalling around \$800,000 as had previously been represented. The representations conveyed by these emails formed part of a course of conduct which led the Balcatta applicants to hold a view at the time they entered into the franchise agreement and guarantees that the likely upper limit of establishment costs would be around \$800,000.

285 Mr Hagemrad’s attachment to the 10 January 2017 email represented that the total “start up” or “fitout” costs for Wetherill Park was likely to be about \$800,000, comprising the equipment identified in the email costing about \$200,000 and “fitout, fixtures, fittings, signage, branding, etc” at between \$500,000 and \$600,000.

286 As discussed further below, I conclude that Mr K Girgis, Mr S Girgis and Mr Chau did not understand from Mr Hagemrad's response in the 10 January 2017 email that the total amount of \$800,000 did not include the Life Fitness equipment.

*Conclusions as to reliance at the time of entering into the franchise agreement*

287 It is necessary to say more about the course of events up until the point in time when the franchise agreement and the guarantees were entered into and events which occurred shortly thereafter.

288 On 30 January 2017, Mr Hagemrad responded to an email from Mr Chau who had asked "if the figures we used [in the Updated Cash Flow] are accurate". Mr Hagemrad confirmed that the Updated Cash Flow "appears to be in line with current expenses at the newly operating club in Western Sydney", namely Wetherill Park. This was incorrect in that the Updated Cash Flow did not contain any expense for hire purchase or operational leases. The Cash Flow Template which had been provided by UFG contained a line item for the former, but not the latter. Mr Hagemrad's response was not specifically pleaded as conveying a misleading representation, but it is referred to as part of the relevant events occurring before entering into the franchise agreement and guarantees.

289 When the two cash flows had been prepared and sent to Mr Hagemrad on 9 and 17 June 2016, Mr Hagemrad contemplated that the Life Fitness equipment was included in the estimate which he had given of \$500,000 to \$800,000 for "establishment costs". I reach that conclusion because:

- The likely cost of a 48 month lease of the Life Fitness equipment would have been one of the major expenses, probably the second most significant after rent. Neither the Draft Cash Flow nor the Updated Cash Flow provided for such a significant expense as an operational expense. If Mr Hagemrad had intended for the Life Fitness equipment to be an operational expense, separate and additional to what was being discussed as "start-up costs", the expense would not have been overlooked when he considered the Draft Cash Flow and Updated Cash Flow in June 2016.
- If Mr Hagemrad had intended that the Life Fitness equipment was an operational expense separate and additional to the equipment in paragraph (b) of Table 1 of the First Disclosure Document dated 31 March 2016, it would have been included in Table 2 or Table 3 of that disclosure document.

290 The conclusion is also fortified by the email sent by Mr Oman of Life Fitness on 24 June 2016 referred to earlier in which Mr Oman stated:

Whilst I was driving home, I had a think about the discussion we had around the \$700,000 cost that you are indicating to potential franchisee[s]. I know this has been designed to accommodate the fit out costs and the costs of equipment, but it really doesn't need to. When you show a \$700,000 cost in fitting out a facility, you are indicating that the equipment will cost the client \$350,000 .... But that isn't really the case.

The equipment will be a monthly expense to the franchisee, and will have only a small impact on their capex initially. Whilst they will need to pay for the builder, the franchise fees and some of the soft accessory products up front, the bulk of the equipment will be leased over a longer period through our internal finance.

A new franchisee will only be liable for around \$8,000 before they open the doors (their first monthly repayment). After that, the equipment repayments are simply a monthly expense on the budget and are considered in their profit and loss projections.

291 There is no reason to think Mr Oman's contemporaneous report of his conversation with Mr Hagemrad is anything but accurate.

292 After entering into the franchise agreement and guarantee, Mr Chau was surprised to learn that the Life Fitness equipment was not included in the amount of \$800,000 which had earlier been discussed.

293 As noted earlier, on 28 March 2017, Mr Chau sent an email to Mr Hagemrad, Mr K Girgis and Mr S Girgis which included:

I just wanted to confirm with you what is the anticipated investment required to start up the gym, I understand that we can't be certain as each site differs but from my understanding from our previous discussion we have always discussed a figure of approx. 800k total.

I spoke to Jason today and he tells me it's more like 1.2M and that the 800k does not include the cost of the life fitness gym equipment. I have always been under the impression that 800k was the total investment inclusive of all equipment.

Can you please confirm

294 Mr Hagemrad responded by email on 28 March 2017 stating:

At all times including the most recent visit by Sherif and Karim the invested was purported fall within \$700K to \$900k plus GST. This figure is a best guess and is based on numerous variables and unknowns. The Life Fitness equipment has always been discussed as an operating lease and not a capital expenditure. I was present when the guys were discussing the numbers with Sam on site at Wetherill Park and the Life Fitness equipment was always reported to be on an operating lease.

In this instance the total investment remains in the vicinity of \$700-\$900 plus GST.

I hope this clarifies it for you.

295 Mr Chau responded by email on 29 March 2017, stating:

Thanks Maz for the confirmation

Any info you can provide me about the life fitness financing deal would be great so I can see what is required

296 Mr Chau's response of 29 March 2017 was not explained by the evidence. There are various possible explanations for it, none of which seem more likely than another.

297 I accept that Mr Chau was genuinely surprised to learn, shortly before he sent his email on 29 March 2017, that the Life Fitness equipment was not included in the total start-up costs of around \$800,000 which had been discussed.

298 I conclude that, when entering into the franchise agreement and guarantee, Mr Chau:

- (a) thought that the total for fit-out and all equipment for Wetherill Park was likely to be around \$800,000;
- (b) thought the Life Fitness equipment was included in Table 1 of Schedule 5 of the First Disclosure Document and in the estimates which had been given of start-up costs of between \$500,000 and \$800,000;
- (c) did not know that the Life Fitness equipment for Wetherill Park was treated as an operational expense.

299 In cross-examination, Mr K Girgis stated:

What Mr Hagemrad was saying in this email is that you and your brother were told by Mr Hussein during the Wetherill Park tour that the Life Fitness equipment was not to be acquired as a capital expenditure, but on an operating lease. Do you agree with that summary of this email?---No. That wasn't the case, and Mr Hagemrad wasn't present when we asked Sam. He was at least 15 metres away, so that's a lie.

300 Later in cross-examination, Mr K Girgis stated:

But when you saw Mr Hagemrad's email of 28 March 2017, you did not respond to him saying that no such thing occurred during the Wetherill Park tour. That's the case, isn't it?---That's right. I had spoken to Paul about it, but not Mr Hagemrad.

And the reason why there was no email in response from you is because what Mr 15 Hagemrad set out in his email of 28 March 2017 did actually take place. That's the case, isn't it?---No. That's false.

The reason why you didn't see any need to correct what Mr Hagemrad had said was because, when you were on the tour of the Wetherill Park gym on 10 December 2017 20 – I'm sorry, 10 December 2016, Mr Hussein said to you, "The fit-out cost doesn't include the Life Fitness equipment. It will be an operating lease with life fitness." That's what was said to you, isn't it?---He did not say that. No.



301 I accept that Mr K Girgis had no recollection of being told by Mr Hussein that the Life Fitness equipment would be on operating lease. This is either because it was not said by Mr Hussein or because Mr K Girgis was not present when it was said or did not digest the comment.

302 I have earlier accepted that Mr K Girgis was told by Mr Hussein that he was “pretty sure [the Life Fitness equipment was] all included in the costs we’ve sent through” and that Mr Hagemrad later confirmed that it was included in the disclosure document previously sent. I conclude that, when entering into the franchise agreement and guarantee, Mr K Girgis:

- (a) thought that the total for all fit-out and all equipment for a new UFC franchise in 1,000 square metre premises was likely to be around \$800,000;
- (b) thought the Life Fitness equipment was included in Table 1 of Schedule 5 of the First Disclosure Document and in the estimates which had been given of start-up costs of between \$500,000 and \$800,000;
- (c) did not know that the Life Fitness equipment for Wetherill Park was treated as an operational expense.

303 I accept that, when entering into the franchise agreement and guarantee, Mr S Girgis:

- (a) thought that the total for all fit-out and all equipment for a new UFC franchise in 1,000 square metre premises was likely to be around \$800,000; and
- (a) thought that the Life Fitness equipment was included in Table 1 of the First Disclosure Document and in the estimates which had been given of start-up costs of between \$500,000 and \$800,000.

304 Having regard to the evidence given by Mr S Girgis referred to earlier, it is possible that Mr Hussein said to Mr S Girgis on 10 December 2016 that the Life Fitness equipment for Wetherill Park was treated as an operational expense, either when Mr K Girgis was not present or in circumstances in which the statement was not properly digested by him. If he did, Mr S Girgis did not communicate that fact to Mr K Girgis or to Mr Chau before Mr Chau sent his email on 28 March 2017.

305 Even if Mr S Girgis was told by Mr Hussein that the Life Fitness equipment for Wetherill Park was treated as an operational expense, that does not alter my conclusion that Mr Chau, Mr K Girgis and Mr S Girgis each thought that the Life Fitness equipment was included in Table 1 of Schedule 5 of the First Disclosure Document and in the estimates which had previously been given by Mr Hagemrad of total start-up costs of between \$500,000 and \$800,000.

306 By the time they entered into the franchise agreement and guarantees, and because of the various representations which had been made over the course of their dealings with UFG, Mr Hagemrad and Mr Hussein, each of Mr K Girgis, Mr S Girgis and Mr Chau thought that the total cost of fit-out and all equipment would be in the order of \$800,000.

307 On no occasion were they expressly told that the amount of \$500,000 to \$800,000 which had been discussed did not include the Life Fitness equipment. On no occasion were they told that the Life Fitness equipment was not included in Table 1 of Schedule 5 of the First Disclosure Document.

308 I accept that Mr Hagemrad said to Mr K Girgis that the Life Fitness equipment was included in the costings in the disclosure document previously provided. One reading of Mr Hagemrad's response in the 10 January 2017 email could lead one to conclude that the Life Fitness equipment was not included in the amount of \$800,000 discussed in relation to Wetherill Park (unless it was included in "fit-out"), but none of Mr K Girgis, Mr S Girgis or Mr Chau in fact understood the response in this way.

309 I accept that when each of Mr K Girgis, Mr S Girgis and Mr Chau entered into the franchise agreement and their respective guarantees, each acted on the basis that the total cost of fit-out would be about \$600,000. They had consistently been told it was likely to be less than that until 10 January 2017 when it was represented to be about \$600,000 in relation to Wetherill Park. They were told there were preferential agreements in place with suppliers.

310 The fact that the cost of fit-out had earlier been represented as less would have given them comfort in working with a maximum figure for fit-out of about \$600,000. The representations which had been made before 10 January 2017 and in the First Disclosure Document would naturally be taken into account in assessing both the risk of fit-out costs exceeding \$600,000 and in considering the amount by which it might be exceeded, if at all.

311 I accept that Mr Chau knew that the total start-up costs might exceed \$800,000, as he conceded. That does not detract from his reliance on what he had been told would be the likely start-up costs. The representations which had been made would naturally be taken into account in assessing both the risk of costs exceeding the range given and the amount by which the maximum in the stated range might be exceeded.

312 In cross-examination, Mr Chau gave the following evidence (at T305):

Isn't the true position this? You had done your due diligence. You had made up your

mind to become a UFC franchisee, and you were not relying on anything which UFG, by this stage, was telling you about establishment costs?---If I had seen these costs [being those set out in the Second Disclosure Document], then I definitely wouldn't have entered. So does that answer the question?

313 I accept this evidence. The costs indicated in the Second Disclosure Document were significantly higher than what had been disclosed up until that point in time and would naturally have led to a re-evaluation of what the likely costs would be and a re-evaluation of whether to proceed.

314 I conclude that each of Mr K Girgis, Mr S Girgis and Mr Chau entered into the franchise agreement and their respective guarantees because of the respondents' conduct, which included the making of each of the representations which I have earlier concluded were conveyed. I recognise that, at the point of entering into the franchise agreement and guarantees, some of the representations were relied on more heavily than others. Nevertheless, having regard to the cumulative effect of the representations, it is right to say that the Balcatta applicants entered into the franchise agreement and guarantees because of each of the representations, assessed in the context of the whole course of conduct.

315 In reaching these conclusions, I have taken into account the specific circumstances of each of Mr K Girgis, Mr S Girgis and Mr Chau and their differing levels of experience, referred to earlier. I have also taken into account their evidence, set out earlier, including in particular about reading the First Disclosure Document, in particular the "boxed" section in Schedule 5 and the "Important Note" at the end of that schedule.

### **Misleading conduct: Issues 5 to 7**

316 Issues 5 to 7 were:

- (5) To the extent any representations were with respect to future matters, whether the respondents have adduced "evidence to the contrary" within the meaning of s 4(2) of the ACL.
- (6) To the extent any representations were with respect to a future matter, whether the respondents had reasonable grounds to make the representations.
- (7) Whether the respondents engaged misleading or deceptive conduct, in contravention of s 18 of the ACL in respect of any:
  - (a) representations with respect to a future matter; and
  - (b) the balance of any representations made.

317 These issues can be addressed together. Section 4 of the ACL makes it necessary to give individual consideration to each representation as to a future matter.

### ***Income representations***

318 I have found that the income representations were not made.

319 I note that these representations were representations as to a future matter and that the respondents did not seek to establish reasonable grounds for the representations, their case being confined to not having made the representations: T661.14.

### ***Establishment costs representations***

*19 January 2016*

320 The respondents did not submit that there was “evidence to the contrary” within the meaning of s 4(2) of the ACL, or seek to establish in closing submissions that there were reasonable grounds for making the representations on 19 January 2016 that a UFC Gym would be able to be established for start-up costs in the range of \$500,000 to \$800,000, such costs including fit-out, all equipment, working capital and the franchise fee of \$60,000.

321 There was no evidence of how the range of \$500,000 to \$800,000 was in fact calculated, presumably reflecting Mr Hagemrad’s position that the representation was not made.

322 It follows that Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1). Mr Hussein adopted the representation by his conduct and silence.

323 If it had been necessary, I would in any event have concluded that there were not reasonable grounds for the representation. There was no evidence as to how fit-out costs were or could have been estimated. As to equipment, as referred to below in relation to the First Disclosure Document, quotes had been obtained from EYE Fitness both of which exceeded \$350,000 exclusive of GST. Taken with Mr K Girgis’s evidence that Mr Hagemrad stated at the 19 January 2016 meeting that equipment was in the range \$200,000 to \$250,000, which I accept, the EYE Fitness quotes establish an absence of reasonable grounds.

*13 April 2016*

324 The respondents did not submit that there was “evidence to the contrary” within the meaning of s 4(2) of the ACL or seek to establish in closing submissions that there were reasonable grounds for making the representation on 13 April 2016 that a UFC Gym would be able to be established for start-up costs in the range of \$500,000 to \$800,000, such costs including fit-out, all equipment, working capital and the franchise fee of \$60,000.

325 I conclude that “evidence to the contrary” was not adduced. It follows that Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1). Mr Husseini adopted the representation by his conduct and silence.

326 If it had been necessary, I would in any event have concluded that there were not reasonable grounds for the representation for the same reasons as just given in relation to the representation made on 19 January 2016.

### *The First Disclosure Document*

327 In closing submissions, the respondents relied upon two quotations as constituting “evidence to the contrary” within the meaning of s 4(2) of the ACL and as establishing reasonable grounds for making the representations in the First Disclosure Document about equipment.

328 The first was a quote for equipment dated 17 November 2015 from EYE Fitness for a gym of 1000 square metres. It was in an amount of \$381,933.96, exclusive of GST. The second was a quote dated 24 November 2015 from EYE Fitness for a gym of 1000 square metres. It was in an amount of \$363,602.58, exclusive of GST. The representation in Table 1 of Schedule 5 of the First Disclosure Document was that the “lease or purchase of equipment” was in the range \$250,000 to \$350,000, exclusive of GST.

329 The majority of the evidence addressing reasonable grounds was introduced by a late affidavit of Mr Hagemrad dated 16 March 2023. In addition to what was stated in the affidavit, Mr Hagemrad gave oral evidence. In relation to the First Disclosure Document his evidence about his involvement in the preparation of Table 1 was that he “would source various quotations and invoices, and then a discussion with the board to come up with the figures”: T465.

330 No evidence was given as to the way in which the EYE Fitness quotes were taken into account or what process was undertaken to determine from the quotations an appropriate range for the expected cost for the “lease or purchase of equipment”. It was not clear from the evidence whether the quotations covered all of the equipment which would be required to establish or start operations in a UFC Gym or whether that was assumed. Whilst it is clear that the quotes cover more than cardio and strength equipment, I do not infer that the quotations covered all equipment when evidence to that effect could so easily have been given and tested.

331 Even if the evidence given by Mr Hagemrad was sufficient to qualify as “evidence to the contrary”, neither quotation provided reasonable grounds for making the representation in the

First Disclosure Document. Whether the First Disclosure Document's range of \$250,000 to \$350,000 was a GST inclusive or GST exclusive price, both quotations exceeded the maximum or upper limit of the range.

332 If Mr Hagemrad's evidence was truthful, about which I have significant doubt, and he did take the EYE Fitness quotations into account, it reflects poorly on Mr Hagemrad's credit, and on "the board", that they discussed quotations for equipment in the range of \$363,602.58 to \$381,933.96, exclusive of GST, and proceeded to include a range of \$250,000 to \$350,000 in the First Disclosure Document for "lease or purchase of equipment".

333 The question whether a person had reasonable grounds for expressing an opinion with respect to a future matter, is assessed as at the date of the representation – see: *Sykes* at 513. As noted earlier, the First Disclosure Document was sent on 1 July 2016. At this time, there was even more material known to Mr Hagemrad indicating that the range stated in the First Disclosure Document was significantly understated, including in the email of 16 May 2016 from Mr Oman of Life Fitness and the three emails from Mr Oman of 24 June 2016. As at the date the First Disclosure Document was sent, Mr Hagemrad must have known that the amount shown as the likely range of expenditure for "lease or purchase of equipment" was grossly understated. There is no reason to think that Mr Hussein, who signed the First Disclosure Document, would not also have been aware that the amount was understated. He was presumably a member of "the board" with whom Mr Hagemrad says he discussed the figures.

334 As to the lower and upper limits of the range given for "building, construction and fitout costs" in the First Disclosure Document, the respondents did not rely on any evidence for the representation that the lower and upper limits of the range were \$190,000 - \$360,000: T85.14. It was not even suggested that inquiries had been made in that respect.

335 It follows that "evidence to the contrary" was not adduced in relation to the range given for fit-out costs with the result that the respondents are taken not to have had reasonable grounds for the representation and the representation is deemed to be misleading and deceptive. I would in any event have held that the Balcatta applicants had established that there were not reasonable grounds for making the representation concerning fit-out costs.

*16 July 2016*

336 The representation that there were "preferential agreements" with suppliers which would benefit franchisees was a representation of existing fact. It was also a representation as to a

future matter because, in context, it constituted a representations that preferential agreements were likely to be in place at the time when the Balcatta Franchise was being established.

337 In so far as it was a representation as to existing fact, I conclude that it was misleading or deceptive. The only evidence of a “preferential agreement” with a supplier as at 16 July 2016 was that Life Fitness would give to UFG an amount of 10% of the price paid by franchisees for equipment. This was more in the nature of profiteering from the franchisees than securing “preferential agreements” for them with suppliers. There was no suggestion that this was disclosed to the franchisees. I conclude it was not disclosed and that it first became apparent in Mr Hagemrad’s affidavit filed shortly before the hearing.

338 Further, as later events demonstrated, UFG (by Mr Hagemrad) marked up prices it charged for equipment to franchisees, sometimes quite considerably. There were a number of examples given, but I will only refer to one. Mr Hagemrad was taken to an invoice dated 25 August 2016 which recorded a charge to UFG of \$6,859.57 for a dumbbell set described as “LZBU2.5-60KG”: T515.36. An Australian Customs record shows that this was imported to Australia by “Strategy Squared” and that various charges applied on entry for home consumption, bringing the total cost to \$9,481.27. When it came to the supply of equipment of that type to Mr Mirdjonov (Castle Hill), the price charged by UFG was \$27,250.

339 Mr Hagemrad’s evidence included at T516:

Yes. And in relation to the Castle Hill price of 27,250, that’s at least 200 per cent mark-up and closer to 300 per cent, isn’t it?---No, I disagree.

No. It’s almost three times the price the UFC franchisor is purchasing it for, including import duties?---Including shipping and carrying costs.

340 Mr Hagemrad accepted that UFG marked up prices for equipment, but disagreed with “the quantum of the mark-up” which had been suggested to him: T516.7. Mr Hagemrad accepted that UFG marked up the equipment by more than the price of the goods plus their customs, duties and GST: T520.6.

341 When it was put to Mr Hagemrad that the charging of mark-ups to franchisees was not something that was disclosed to franchisees in the disclosure documents he answered: “I’m not too sure if there’s a section for disclosing margins”. There was no evidence to the effect that the charging of mark-ups or margins was ever disclosed to the franchisees. I conclude that it was not.

342 **Strategy Squared** Pty Ltd was a company of which Mr Hagemrad’s wife was a director and  
in which she and he were shareholders. Mr Hagemrad denied that the gym equipment  
importation arrangements enabled his wife to profit (T517.2) and denied that it was a company  
that “purports to be a logistic company charging franchisees for the transport and customs of  
equipment that’s imported”: T517.13. He was then taken to an invoice for \$26,620.44 issued  
by Strategy Squared to Girchow and accepted it was an invoice for cartage by truck from  
Sydney to Perth: T519.43; Exhibit 18.2. There was no evidence that the franchisees were  
informed of any connection between Strategy Squared and Mr Hagemrad and Mr Hagemrad  
appeared to accept that they were not: T520.

343 As to “preferential agreements” with suppliers of fit-out, there was no evidence of the existence  
of any as at 16 July 2016 or at any later date.

344 Mr Hagemrad arranged for the Blacktown and Castle Hill fit-outs to be carried out by his  
brother in law’s company, **Intrex** Projects Pty Ltd. Mr Hagemrad confirmed that Intrex was  
UFG’s “approved supplier” for all the Sydney franchisees: T490.25. Intrex did not apparently  
carry out at least most of the fit-out for the Balcatta Franchise in Perth, but there was an  
unexplained charge of \$106,500 by Intrex to the Balcatta builder (Carbon Developments Pty  
Ltd): Exhibit 16. It was put to Mr Hagemrad in cross-examination that this was a “kick-back”.  
This was denied: T492.41. It was not addressed in Mr Hagemrad’s re-examination which was  
conducted the day after his cross-examination and after conferring with his legal  
representatives. I reach no conclusion about it. Mr Hagemrad’s connection with Intrex was  
not disclosed to any of the franchisees. These secret arrangements with a related party do not  
evidence “preferential agreements” for the benefit of franchisees.

345 To the extent the representation that there were “preferential agreements” with suppliers is one  
as to a future matter, namely that preferential agreements were likely to be in place when the  
Balcatta gym was being established, “evidence to the contrary” of the representation was not  
adduced. It follows that an absence of reasonable grounds for the representation is deemed and  
that the representation is taken to be misleading: s 4(2) and (1).

346 The representation was misleading both as a representation of existing fact and to the extent it  
was a representation with respect to a future matter.

347 As to the representations on 16 July 2016 about fit-out and equipment costs, the respondents  
did not contend that they had adduced “evidence to the contrary” or that there were reasonable



grounds beyond what had been relied upon in relation to the First Disclosure Document. The representations are, therefore, taken to be misleading or deceptive.

*23 September 2016*

348 As to the representation that the “costings” for the Wetherill Park premises were, as at 23 September 2016, as “per ... original estimations” meaning that the start-up costs – comprising fit-out and all equipment – were proving to be within the range of \$500,000 to \$800,000, the respondents did not contend that they had adduced “evidence to the contrary” or that there were reasonable grounds beyond what had been relied upon in relation to the First Disclosure Document. The representation is, therefore, taken to be misleading or deceptive.

*The Second Disclosure Document*

349 I have earlier concluded that the Second Disclosure Document, dated 31 October 2016, was not read by Mr K Girgis, Mr S Girgis or Mr Chau. The question whether the representations made in the Second Disclosure Document are misleading or deceptive does not therefore directly arise in relation to the Balcatta applicants. Nevertheless, it is indirectly relevant and a materially identical disclosure document is relevant to the Blacktown Franchise (and Mr Kim) so it is addressed now.

350 The Second Disclosure Document represented that the total cost for equipment required to operate a UFC Gym, whether that equipment was leased or purchased, was likely to be in the range of between \$300,000 to \$500,000.

351 In closing submissions, the respondents relied on 6 equipment invoices and quotes which were available as at the date of the Second Disclosure Document. These were set out in an aide memoire. It is unnecessary to repeat the detail of it. It is sufficient to note that the aide memoire was accurate and that the various calculations of the 6 invoices and quotes revealed a range for the equipment lease or purchase of between \$361,862 and \$404,995, exclusive of GST. It was not suggested in submissions that these calculations reflected anything which in fact occurred when the Second Disclosure Document was prepared by Mr Hagemrad.

352 In his oral evidence in chief, which supplemented his late filed affidavit addressing reasonable grounds, Mr Hagemrad was taken to the Second Disclosure Document and asked (at T466) without objection:

Were you involved in the preparation of those figures for inclusion in this document?--Yes, I was.

Did you refer to documents when you prepared those figures?---Yes, I did.

Have you referred to those documents in your most recent affidavit?---Yes, I have.

And where have you referred to those documents in your most recent affidavit?---  
Apologies, they're in paragraph 9.

353 The documents in paragraph 9 of Mr Hagemrad's affidavit include emails not apparently sent to Mr Hagemrad. I doubt that Mr Hagemrad in fact referred to each of the documents in paragraph 9 of his affidavit at the time he prepared the Second Disclosure Document.

354 I have referred earlier to what is required to constitute "evidence to the contrary" – see: [16] to [18] above.

355 No evidence was given as to the way in which the various documents (quotations and emails) in paragraph 9 were in fact taken into account or what process was in fact undertaken in determining the amounts represented to be the range for "lease or purchase of equipment". Importantly, the evidence did not establish that the quotations and emails – which related both to fit-out costs and equipment – in fact incorporated costs for the whole fit-out or all equipment which would be required to establish or start-up operations in a UFC Gym or that an assumption in that regard was made by Mr Hagemrad. I would not draw either inference. Inferences can be drawn, and should be drawn where appropriate. It was well within Mr Hagemrad's ability to establish that the quotes and invoices covered everything he considered necessary to establish a UFC Gym. If he had given that evidence it could have been tested by putting to him various items which had been omitted. The evidence was not given.

356 Further, even if I were satisfied that Mr Hagemrad in fact took the documents referred to into account in preparing Table 1 of the Second Disclosure Document, which I doubt, I am unable to determine from the evidence adduced how that material was used or what the "grounds" in fact were for Mr Hagemrad's range for "lease and purchase of equipment". As noted earlier, the evidentiary onus which s 4(2) creates is not necessarily discharged simply by adducing some evidence which is objectively capable of providing some support for a contention that there were reasonable grounds for making a representation with respect to a future matter and stating that the material was referred to at the time.

357 Evaluating the evidence given by Hagemrad as a whole, and in the context of the contemporaneous documents, I am not satisfied that there is "evidence to the contrary" within the meaning of s 4(2). It was not submitted that Mr Hussein – who signed the Second

Disclosure Document – had adduced evidence to the contrary. His evidence was silent on the topic.

358 It follows that Mr Hussein, Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1).

359 If it had been necessary, I would have held that the applicants had established that there were not reasonable grounds for making the representation about the total cost for “lease or purchase of equipment”, taking into account the matters just mentioned and the actual costs of equipment. The actual costs of equipment provide some evidence as to what was reasonably likely at the relevant time – see: *Jazabas* at [83]. To use Balcatta as an example, the actual costs on a GST exclusive basis for “lease or purchase of equipment”, including Life Fitness equipment, far exceeded \$500,000 exclusive of GST and included at least (but arguably more than):

• Life Fitness	\$ 360,000.00 (approx)
• UFC Equipment (gym)	\$ 222,112.60
• <u>UFC Equipment (juice bar)</u>	<u>\$ 12,038.26</u>
Total	\$ 594,150.86

360 In the absence of any real assistance from the parties on the issue, these amounts have been determined from a combination of Mr K Girgis’s oral evidence about the Life Fitness equipment, the invoices in Mr K Girgis’s first affidavit and Annexure 7 to the referee’s report referred to at [596] below. Mr K Girgis confirmed that the invoiced amount of \$411,323 was not what was ultimately paid and the amount was around \$395,000 (inclusive of GST).

361 There was no reasonable basis for representing in the Second Disclosure Document that equipment could be as low as \$300,000 (exclusive of GST). As Mr Hagemrad must have known, this was unlikely to have covered more than the Life Fitness equipment alone and was unlikely even to cover that. There were no reasonable grounds for suggesting that the likely upper limit was \$500,000 (exclusive of GST). There may have been reasonable grounds for this amount being within the range of likely costs, but not for representing that it was the likely upper limit (see cl 14.5 of the Second Disclosure Document). In reaching these conclusions, I have sought to take hindsight bias into account – see: *Jazabas* at [83].

362 In relation to the representation in the Second Disclosure Document that fit-out would be in the range of \$300,000 to \$450,000 (inclusive of GST), in closing submissions the respondents relied upon a variety of invoices and quotations of various dates which both pre-dated and post-dated 31 October 2016 and which related to the Wetherill Park gym. This was advanced as relevant also to the disclosure document given to Mr Mirdjonov in relation to the Castle Hill Franchise, which identified a higher amount for fit-out.

363 No evidence was given as to the way in which the quotations and invoices were taken into account (to the extent they were available before 31 October 2016) or what process was in fact undertaken in determining the amounts represented to be the range for fit-out. No evidence was given as to what was expected by way of fit-out at the time of the representation or to the effect that the invoices and quotations which had been received covered everything that was then expected to be required. Significantly, no evidence was given to the effect that the quotations and invoices in fact covered all of the fit-out costs which were anticipated at the time of making the representation or the total expected fit-out costs for Wetherill Park. That is not an inference I would draw having regard to all of the evidence.

364 In my view, the evidence given did not amount to “evidence to the contrary” within s 4(2). All that was adduced was a series of quotations and invoices to which Mr Hagemrad said he had regard in some unidentified way at the time of making the representation. I should not be taken as accepting that Mr Hagemrad in fact had regard to the documents when making the representation. But, even accepting he did, the evidence does not permit any reliable conclusion as the facts and circumstances Mr Hagemrad actually relied on making the representation.

365 It follows that Mr Hussein, Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1).

366 If it had been necessary, I would have held that the Balcatta, Blacktown and Castle Hill applicants had established that there were not reasonable grounds for making the representation, taking into account the matters just mentioned and the actual costs of fit-out. On any reasonable view of what comprised fit-out – and noting for the Balcatta applicants they had been told that “fit-out” including such matters as flooring, AV, fittings, signage, branding and so on – the fit-out for each of the franchises significantly exceeded what had been represented to the franchisees. Mr Hagemrad managed all aspects of the fit-out for the

franchisees: T448.12-27 (Mr Laurence); T489-490 (Mr Hagemrad). To use Balcatta as an example, the actual costs on a GST exclusive basis included at least (but arguably more than):

• Builder (Carbon)	\$ 490,030.00
• Intrex	\$ 92,935.55
• Intrex (BBJ/Octagon)	\$ 45,411.05
• Intrex (Inv 1149)	\$ 55,200.00
• Signage (De Sign)	\$ 74,219.00
• <u>Amazed AV</u>	<u>\$ 68,700.00</u>
Total	\$ 826,495.60

367 These amounts have been determined primarily from Annexure 7 to the referee's report referred to at [596] below, checked against the invoices in Mr K Girgis's affidavit. It is possible that one or both of the two lower amounts paid to Intrex may have been regarded as equipment but if that is so, then "fit-out" costs were still far in excess of \$600,000 and the representation about equipment costs was grossly out of line with actual costs.

368 I note also that it was well within the respondent's ability to prove the total actual costs for the fit-out for Wetherill Park, which would have been relevant to whether there were reasonable grounds for making the representation in the Second Disclosure Document. Accurate records are likely to have been kept for tax and other reasons, including to calculate deductions, depreciation and cost bases of assets.

*10 December 2016*

369 As to the representation made by Mr Hussein on 10 December 2016 that the Life Fitness equipment was included in the start-up costs in the First Disclosure Document and the equivalent representation made by Mr Hagemrad shortly thereafter, these were not representations with respect to future matters.

370 They were correct in the sense that paragraph (b) of Table 1 of Schedule 5 of the First Disclosure Document concerned all equipment, including Life Fitness equipment. They were misleading in the sense that the amounts in paragraph (b) could not, at the time, in fact have covered both the Life Fitness equipment and the other equipment which would be required.

*10 January 2017*

371 It was represented on 10 January 2017 that the cost of fit out, fixtures, fittings, signage, branding and such like would be likely to be between \$500,000 and \$600,000.

372 As mentioned, in closing submissions, the respondents relied upon a variety of invoices and quotations of various dates which related to the fit-out at Wetherill Park. No evidence was given as to the way in which the quotations and invoices were taken into account or what process was in fact undertaken in determining the amounts represented to be the range for fit-out. No evidence was given as to precisely what was then expected by way of fit-out or to the effect that the invoices and quotations which had been received covered everything that was expected to be required. I do not accept that what was done amounted to the adducing of “evidence to the contrary” within the meaning of s 4(2) of the ACL.

373 It follows that Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1). In any event, for reasons given earlier, I am satisfied that there were not reasonable grounds for making the representation about fit-out in the email of 10 January 2017.

### ***The conduct***

374 I am satisfied, after considering the representations in respect of establishment costs made in the context of the whole course of events, that Mr Hagemrad and Mr Hussein, and through them UFG, engaged in misleading conduct in contravention of s 18 of the ACL.

## **LIABILITY: BLACKTOWN FRANCHISE**

### **Factual Background**

#### ***25 September 2016 to 1 October 2016***

375 On 25 September 2016, Mr Kim sent an email to Mr John Price (an executive director of UFG) and Mr Hagemrad attaching a “Franchise Application”, comprising a five page form which had been completed in handwriting.

376 On 1 October 2016, Mr Hagemrad sent an email to Mr Kim attaching a “Business Plan” template and a “Cash Flow” template.

377 The business plan template was in a different form to that which had been provided by UFG in relation to the Balcatta franchise. A lot more guidance was provided in relation to the sort of information which was being sought. It continued to require a SWOT analysis.

378 The cash flow template was in similar form to that which had been sent in relation to the Balcatta franchise. The cash flow template contained no figures for any particular item of income or expense. As with the Balcatta Franchise, it contained four written assumptions at the end.

***3 and 4 October 2016: First meeting and emails***

379 There was a meeting between Mr Kim, Mr Price and Mr Hagemrad on 3 October 2016. Mr Kim did not address this meeting in his first affidavit. In his first affidavit, Mr Hagemrad stated:

35 On 1 October 2016 I sent Richard an email ... I then met Richard with John Price, the Business Development Manager for UFG at a cafe located within the complex of units at 1183 - 1187 The Horsley Drive where the Wetherill Park gym is located. During that meeting I recall a discussion about the history of the business, the differentiated value proposition of the business, the size range of the clubs being ideally 800sqm up to 2000sqm with 1200sqm being the sweet spot, the number of clubs globally and countries they operate in. I recall a discussion about the UFC Gym in Alexandria and explaining the difference between that "Signature" club and the new design of clubs such as Wetherill Park. I recall a discussion about the site at Wetherill Park that was in early stages of construction.

36 During that discussion I said words to the effect "the start up costs range between \$500K to approx. \$800K excluding GST and excluding pre-sale costs such as wages, marketing and casual leasing". I also recall saying words to the effect "The Strength and Cardio Equipment should be on an operating lease and not factored in as a capital expenditure". I also recall discussing the stages of the Franchisee approval process, including the requirement to send documents over to the US franchisor for approval.

380 In his second affidavit, Mr Kim stated that Mr Hagemrad said that clubs of about 1200 square metres were preferred and that cost estimates were based on clubs of this footprint. He also stated:

6 I deny paragraph 36. Maz did not say that wages, marketing and leasing costs were excluded. All costs were said by Maz to be startup costs and no particular cost was excluded by him during our conversations. At this time no breakdowns were provided.

7 Maz did not say that strength and cardio equipment were excluded from the estimated set up costs.

381 After the meeting on 3 October 2016, Mr Kim sent an email to Mr Hagemrad, copied to Mr Price, asking a series of questions. In the email, Mr Kim confirmed he was working on the cash flow.

382 Mr Hagemrad responded to these questions by email on 4 October 2016, by annotating Mr Kim's email with answers in red font. The email and responses included (errors as per original):

1. Salaries. Assuming Im paying around 18-20/hour? How many staff hrs are needed per week?

Staff requirements vary, however 3 fulltime and 2 part suffice would be a good example of staffing needs.

...

9. What rate would I be paying my GM?

As a guide, GM's would command between \$55,000 - \$70,000 plus performance bonuses.

10. What hire purchase repayments should I expect? I imagine this is set?

Equipment leasing repayments would vary depending on the size of the club and amount of equipment. As a range this could be between \$5000 - \$7,000 per month.

383 Mr Hagemrad's responses included a statement that staffing requirements were variable, however, provision could be made for three full-time and two part-time staff members. Mr Hagemrad also stated "Equipment leasing repayments would vary depending on the size of the club and amount of equipment. As a range this could be between 5,000 – 7,000 per month".

***5 October 2016: Mr Kim emails draft cash flow***

384 On 5 October 2016, Mr Kim sent an email to Mr Hagemrad and Mr Price attaching a draft cash flow and business plan that Mr Kim had populated. Mr Kim's email included:

The business plan is obviously bare without knowing the site or much else about how the franchise system will run however I feel the cash flow projection is realistic.

I would be interested to know if the numbers I have are a realistic expectation.



385 In the cash flow template, Mr Kim projected total revenue of \$591,915, total gross profit of \$514,428 and total trade payments of \$512,153 for the first 12 months of operation, yielding net operating cash receipts of \$2,275. The cash flow provided:

12 Month Cash Flow Worksheet													
	Bugeted Acheivable Scenario												
Receipts	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	Total
Revenue <sup>1</sup> (recurring Dues)	37,916	39,053	40,225	41,432	42,675	43,955	45,274	46,632	48,031	49,472	50,966	52,485	538,105
PT Fees	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250.00	3,250	3,250	3,250	39,000
Retail (merchandise/F&B)	3,792	3,905	4,023	4,143	4,267	4,396	4,527	4,663	4,803	4,947	5,096	5,248	53,810
Total	41,708	42,959	44,248	45,575	46,942	48,351	49,801	51,295	52,834	54,419	56,052	57,733	591,915
Direct Costs													
Purchases <sup>2</sup>	1,896	21,479	22,124	22,788	23,471	24,175	24,901	25,648	26,417	27,209	28,026	28,867	277,000
COGS (45%)	1,706	1,757	1,810	1,864	1,920	1,978	2,037	2,098	2,161	2,226	2,293	2,362	24,215
Sales Rec Less Direct Costs	40,001	41,201	42,437	43,711	45,022	46,373	47,764	49,197	50,673	52,193	53,759	55,371	567,701
Advertising (2%) <sup>3</sup>	834	859	885	912	939	967	996	1,026	1,057	1,088	1,121	1,155	11,838
Royalty (7%) <sup>3</sup>	2,920	3,007	3,097	3,190	3,286	3,385	3,486	3,591	3,698	3,809	3,924	4,041	41,434
Gross Profit	36,248	37,335	38,455	39,609	40,797	42,021	43,282	44,580	45,917	47,295	48,714	50,175	514,428
Trade Payments													
Accounting & Legal Costs	400	-	1,000	400	-	-	400	-	-	400	-	-	2,600
Bank & Merchant Charges	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Bookkeeping	-	-	-	-	-	-	-	-	-	-	-	-	-
Electricity	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Gas	50	50	50	50	50	50	50	50	50	50	50	50	600
Insurance	300	300	300	300	300	300	300	300	300	300	300	300	3,600
Equipment Lease	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	72,000
Marketing (LSM)	1,137	1,172	1,207	1,243	1,280	1,319	1,358	1,399	1,441	1,484	1,529	1,575	16,143
Office Expenses	250	250	250	250	250	250	250	250	250	250	250	250	3,000
Rent	-	-	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	166,660
Repair & Maintenance	650	650	650	650	650	650	650	650	650	650	650	650	7,800
Salaries & Wages	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	173,400
Superannuation <sup>4</sup> (9.5%)	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	16,473
Telephone	350	350	350	350	350	350	350	350	350	350	350	350	4,200
Workers' Compensation	434	434	434	434	434	434	434	434	434	434	434	434	5,202
Transaction charges	1,706	1,757	1,810	1,864	1,920	1,978	2,037	2,098	2,161	2,226	2,293	2,362	24,215
Other Payments	255	255	255	255	255	255	255	255	255	255	255	255	3,060
Total Trade Payments	28,455	28,140	45,894	45,385	45,078	45,174	45,673	45,375	45,480	45,988	45,699	45,814	512,153
Net Operating Cash Receipts	7,793	9,195	(7,439)	(5,776)	(4,281)	(3,153)	(2,391)	(795)	438	1,307	3,015	4,362	2,275
Less Corporate Tax Instalments	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Trade Receipts	7,793	9,195	(7,439)	(5,776)	(4,281)	(3,153)	(2,391)	(795)	438	1,307	3,015	4,362	2,275
Hire Purchase Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank Loan Repayments Appx	-	-	-	-	-	-	-	-	-	-	-	-	-
Subtotal	7,793	9,195	(7,439)	(5,776)	(4,281)	(3,153)	(2,391)	(795)	438	1,307	3,015	4,362	2,275
Plus Capital Receipts													
New Loan	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Cash Flow	7,793	9,195	(7,439)	(5,776)	(4,281)	(3,153)	(2,391)	(795)	438	1,307	3,015	4,362	
Opening Cash Balance	7,793	16,988	9,549	3,773	(508)	(3,661)	(6,052)	(6,846)	(6,846)	(6,409)	(5,101)	(2,086)	
Closing Cash Balance	7,793	16,988	9,549	3,773	(508)	(3,661)	(6,052)	(6,846)	(6,409)	(5,101)	(2,086)	2,275	

Assumptions:

1. Revenue is expected to increase by a sustainable 3% each month. This is conservatively applied given the location

2. COGS for merchandise should be approximately 50%.

3. Advertising & royalty expenses are fixed to 2% & 7% of the gross income respectively. Except for year 1 where Royalties are Discounted at 4%.

4. 9.5% of gross salary & wages are subject to superannuation

386 As can be seen, the draft cash flow included an amount of \$6,000 per month for “Equipment Lease”. Mr Kim agreed in cross-examination that he include this amount because of what Mr Hagemrad had said in his 4 October 2016 email response to question 10: T401.8. Mr Kim included \$14,450 per month in relation to “Salaries & Wages”. Mr Kim agreed in cross-

examination that he had regard to what Mr Hagemrad had said in his 4 October 2016 email response to question 10.

387 Mr Kim accepted in cross-examination that he made his own inquiries and assessment in relation to the balance of the “Trade Payments” included in the cash flow which he had prepared.

388 In his second affidavit, Mr Kim stated that he completed the expenses “after receiving advice from Maz as to these categories”. Mr Kim confirmed in cross-examination that the draft cash flow included the categories of expense which had been given by Mr Hagemrad: T402.16.

389 On 7 October 2016, Mr Hagemrad responded to Mr Kim’s email of 5 October 2016. He stated:

Hi Richard

Thanks for the documents.

The cash flow needs to be completed with a strategic budget in mind.

For this, I have cc’d Jason [Laurence] our Operations Manager on this email to assist.

Jason will provide you with a conservative plan to build your member numbers.

Unfortunately, in our industry, just growing revenue by a mere 3% is not conducive with the business model.

[W]e focus on member numbers, which in turn drives revenue.

Also, the template you have is the US version, the royalties will need to be amended to 10%.

[F]inally, if you’re available next Friday morning at 8.30am we can arrange the Stage 2 interview at Wetherill Park.

Jason – Can you please assist?

390 As to the comment in the email about a “mere 3%” not being “conducive with the business model”, Mr Hagemrad explained in cross-examination at T489.26:

The three per cent is a month-on-month growth, on top of adding new members and growing. It’s to combat the – you know, the basic CPI growth of cost of doing business.

***10 October 2016: Mr Laurence emails revised cash flow and meeting***

391 On 10 October 2016, Mr Laurence sent an email to Mr Kim attaching “an amended cash flow forecast that we can go over in our call”, noting a call was scheduled at 5pm. Mr Laurence accepted that his **Revised Cash Flow** was reviewed by Mr Hagemrad before Mr Laurence sent the email: T447.28, 447.41.

392 Mr Laurence's Revised Cash Flow indicated total revenue of \$1,373,713 for the first 12 months of operation, compared to Mr Kim's \$591,915. Mr Laurence revised the total trade payments estimated by Mr Kim from \$512,153 to \$565,457. The Revised Cash Flow prepared by Mr Laurence was as follows:

New 12 Month Cash Flow Worksheet													
	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	Total
<b>Receipts</b>													
<b>Memberships Sold</b>	250	150	125	120	120	120	120	80	100	125	120	120	1550
Pre Sale Stage 1 Ave Dues	85.00												
Pre Sale Stage 2 Ave Dues	107.00												
List Price Ave Dues	128.00												
Revenue <sup>1</sup> (occurring Dues)	21,250	37,300	53,300	68,660	84,020	99,380	114,740	124,980	137,780	153,780	169,140	184,500	1,248,830
PT Fees	-	-	-	4,250	5,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250	53,250
Retail (merchandiseF&B)	2,125	3,730	5,330	6,866	8,402	9,938	11,474	12,498	13,778	15,378	16,914	18,450	124,883
<b>Total</b>	23,375	41,030	58,630	75,526	92,422	109,318	126,214	137,478	151,558	169,158	186,054	202,950	1,373,713
<b>Direct Costs</b>													
Purchases <sup>2</sup>	1,063	20,515	29,315	37,763	46,211	54,659	63,107	68,739	75,779	84,579	93,027	101,475	676,232
COGS (45%)	956	1,679	2,399	3,090	3,781	4,472	5,163	5,624	6,200	6,920	7,611	8,303	56,197
<b>Sales Rec Less Direct Costs</b>	22,419	39,352	56,232	72,436	88,641	104,846	121,051	131,854	145,358	162,238	178,443	194,648	1,317,516
Advertising (2%) <sup>3</sup>	468	821	1,173	1,511	1,848	2,186	2,524	2,750	3,031	3,383	3,721	4,059	27,474
Royalty (10%) <sup>2</sup>	2,338	4,103	5,863	7,553	9,242	10,932	12,621	13,748	15,156	16,916	18,605	20,295	137,371
<b>Gross Profit</b>	19,614	34,428	49,196	63,373	77,550	91,728	105,905	115,357	127,171	141,939	156,116	170,294	1,152,670
<b>Trade Payments</b>													
Accounting & Legal Costs	400	-	1,000	400	-	-	400	-	-	400	-	-	2,600
Bank & Merchant Charges	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Bookkeeping	-	-	-	-	-	-	-	-	-	-	-	-	-
Electricity	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Gas	50	50	50	50	50	50	50	50	50	50	50	50	600
Insurance	300	300	300	300	300	300	300	300	300	300	300	300	3,600
Equipment Lease	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	72,000
Marketing (LSM)	638	1,119	1,599	2,060	2,521	2,981	3,442	3,749	4,133	4,613	5,074	5,535	37,465
Office Expenses	250	250	250	250	250	250	250	250	250	250	250	250	3,000
Rent	-	-	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	16,666	166,660
Repair & Maintenance	650	650	650	650	650	650	650	650	650	650	650	650	7,800
Salaries & Wages	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	14,450	173,400
Superannuation <sup>4</sup> (9.5%)	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	1,373	16,473
Telephone	350	350	350	350	350	350	350	350	350	350	350	350	4,200
Workers' Compensation	434	434	434	434	434	434	434	434	434	434	434	434	5,202
Transaction charges	956	1,679	2,399	3,090	3,781	4,472	5,163	5,624	6,200	6,920	7,611	8,303	56,197
Other Payments	255	255	255	255	255	255	255	255	255	255	255	255	3,060
<b>Total Trade Payments</b>	27,205	28,009	46,875	47,427	48,179	49,331	50,883	51,251	52,211	53,811	54,563	55,715	565,457
<b>Net Operating Cash Receipts</b>	(7,591)	6,419	2,321	15,946	29,372	42,397	55,022	64,106	74,960	88,128	101,553	114,579	587,213
Less Corporate Tax Instalments	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Net Trade Receipts</b>	(7,591)	6,419	2,321	15,946	29,372	42,397	55,022	64,106	74,960	88,128	101,553	114,579	587,213
Hire Purchase Repayments	-	-	-	-	-	-	-	-	-	-	-	-	-
Bank Loan Repayments Appx	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Subtotal</b>	(7,591)	6,419	2,321	15,946	29,372	42,397	55,022	64,106	74,960	88,128	101,553	114,579	587,213
<b>Plus Capital Receipts</b>													
New Loan	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Net Cash Flow</b>	(7,591)	6,419	2,321	15,946	29,372	42,397	55,022	64,106	74,960	88,128	101,553	114,579	587,213
Opening Cash Balance	(7,591)	(1,172)	1,149	17,095	46,467	88,864	143,886	207,992	282,952	371,081	472,634	587,213	472,634
<b>Closing Cash Balance</b>	(7,591)	(1,172)	1,149	17,095	46,467	88,864	143,886	207,992	282,952	371,081	472,634	587,213	587,213

**Assumptions:**

1. Revenue is expected to increase by a sustainable % each month. This is conservatively applied given the location
2. COGS for merchandise should be approximately 50%.
3. Advertising & royalty expenses are fixed to 2% & 10% of the gross income respectively. Except for year 1 where Royalties are Discounted at 4%.
4. 9.5% of gross salary & wages are subject to superannuation

393 Consistently with Mr Hagemrad's email of 7 October 2016, Mr Laurence's Revised Cash Flow focussed on member numbers. A new line item was inserted called "Memberships Sold" and this was populated by Mr Laurence.

394 Mr Laurence's Revised Cash Flow contemplated 525 members after three months and 645 members after four months. The cash flow is consistent with the business becoming cash flow positive after three months and having a breakeven point of about 600 members.

395 Mr Laurence corrected the royalty rate to 10%, from the 7% applicable to the US franchises, and made various other amendments.

396 Mr Kim accepted in cross-examination that Mr Laurence's cash flow was a forecast. He accepted that the actual figures might not be exactly the same as had been forecast and accepted that he "did not see it as a guarantee": T404.29.

397 In cross-examination, Mr Hagemrad sought to distance himself from having seen the cash flow which had been revised by Mr Laurence: T495.13. This evidence was feigned. Mr Laurence agreed that the Revised Cash Flow had been reviewed by Mr Hagemrad: T447.28, 447.41.

398 I have no doubt that Mr Hagemrad reviewed the Revised Cash Flow prepared by Mr Laurence before it was sent to Mr Kim. Mr Hagemrad got Mr Laurence involved for the purpose of revising the draft cash flow which Mr Kim had prepared. Mr Hagemrad's email to Mr Laurence of 7 October 2016, sent after Mr Hagemrad had evidently read Mr Kim's draft cash flow, stated that Mr Laurence will "will provide you with a conservative plan to build your member numbers". It is clear that Mr Hagemrad considered that Mr Kim's draft cash flow was inadequate in its forecast of member numbers, growth and consequently in its assessment of income. Mr Laurence confirmed that there was a two stage approval process for franchisees, involving approval by the "local franchisor", namely UFG, and approval by the US franchisor: T446.33. Mr Hagemrad accepted that he reviewed the business plans and cash flows before they were sent to the Master Franchisor: T488.1 to 488.5. Mr Laurence confirmed that, before an application was sent to the US for approval, it was reviewed and approved by Mr Hagemrad: T446.46. As would be expected, Mr Laurence confirmed that it was Mr Hagemrad who decided whether or not a franchisee applicant moved to the second stage: T447.2. Mr Laurence had only recently started working with UFG. This context supports Mr Laurence's recollection that Mr Hagemrad reviewed the Revised Cash Flow before it was sent back to Mr Kim.

399 The Revised Cash Flow which was sent to Mr Kim was radically different in its income projections, and therefore net profits, to what had been prepared by Mr Kim.

400 On 10 October 2016, Mr Kim and Mr Laurence conferred over the telephone to discuss Mr Laurence's revised cash flow forecast. In his first affidavit, Mr Kim stated:

- 15 On 10 October 2016 at about 5 pm I had a teleconference with Jason Laurence to discuss the revised cash flow spreadsheet.
- 16 Jason went through and advised amendments to the cash flow projection spreadsheet, including the revised spreadsheet he sent through that day. This version completed by Jason added some costs but still excluded cleaning, software, sanitation, and recruitment costs.
- 17 Jason repeated what I had been told by Maz ... which was that in the first year cancellations would be “minimal to none” due to the 12 months contracts.
- 18 The cash flow projection showed a 12 month cash balance of \$587,213, which along with the set up cost projections were the primary information I relied on in deciding to become a franchisee.

401 In his affidavit, Mr Laurence stated:

- 6 I refer to paragraphs 15 – 17 of the Kim affidavit. During the discussion with Richard words were said to the following effect about membership:

I said “In the first year cancellations will be low because we are selling fixed term memberships. Your cancellations will be determined by your staff and service offering. If they don’t perform or your gym isn’t operated properly it will impact membership. The new membership budget is based on 2 membership advisors selling 50 memberships each per month and the club manager selling 20 memberships per month”

Richard said “Ok I get it now”

402 In his second affidavit, Mr Kim stated:

- 30 I deny paragraph 6. Jason did not say this to me. The only thing Jason said to me about cancellations was that they would be negligible or words to that effect. He did not [say] anything about staffing or service offering.

403 In cross-examination, Mr Kim stated that he thought the conversation went for about half an hour: T403.13. Mr Kim gave evidence that he did not recall Mr Laurence saying the things he asserted in [6] of his affidavit, but accepted that it was possible that Mr Laurence said those things: T403.37.

404 I accept that Mr Laurence said that cancellations in the first year would be minimal, low or negligible. This statement was inconsistent with his experience in the gym industry generally as he properly conceded: T449.28.

### ***21 October 2016: Meeting***

405 On 21 October 2016, a meeting took place between Mr Hagemrad, Mr Price and Mr Kim. In his first affidavit, Mr Kim stated:

6 On 21 October 2016 I had a meeting with Maz Hagemrad and John Price at the Wetherill Park UFC Gym.

7 During the meeting we had the following discussion:

Maz: The franchises for UFC Gym would be able to be established for startup costs of about \$600,000. This figure of \$600,000 is based on the size of the gym being 800 to 1200 square metres.

Me: I don't have the financial capacity to invest in a business that costs much more than \$600,000.

Maz: I will evaluate your application. You will not be approved if I feel you don't have the capacity.

Me: What about membership cancellations?

Maz: These will be negligible, because they are on 12 month membership plans.

406 Mr Hagemrad stated:

37 I refer to paragraphs 6 and 7 of the Kim affidavit. The meeting on 21 October was the follow up meeting after our initial meeting on 3 October 2016. During this meeting I deny saying a UFC Gym could "be established for set up of about \$600,000". At that time, we were substantially advanced in constructing the Wetherill Park gym, and our costs to set up the gym were going to exceed \$600,000. I deny saying any figure discussed "is based on the size of the gym being 800 – 1200 square meters [sic]". I also deny Richard said "I don't have the financial capacity to invest in a business that costs more than \$600,000". These criteria were presented at the Perth presentation on slide 65.

38 In relation to paragraph 7 of Richard's affidavit I deny saying the words "You will not be approved if I feel you don't have the capacity". Both John Price and I said that his application will go to the US for approval first, followed by board approval in Australia. I do not make approval decisions myself. I also deny making any statement about membership cancellations as there were no UFC gyms then in operation. However, I recall there was a discussion about the various types of memberships we were selling during the 'Pre Sale' for Wetherill Park, including the term of the memberships.

407 Mr Kim's evidence in cross-examination was that, to the best of his recollection, Mr Hagemrad gave the figure \$600,000, and not a range of figures, but accepted it was possible that Mr Hagemrad gave a range: T405. In cross-examination, Mr Hagemrad denied saying that a UFC gym could be established for \$600,000: T486.18.

408 I accept Mr Kim's account. His recollection of events was clearly better than Mr Hagemrad's recollection. I note also that Mr Kim stated during cross-examination that he had a "record" of speaking about the matter with his business partner in the physiotherapy clinics at the time: T405. His business partner was considering investing with Mr Kim. Although the record was

not in evidence, the circumstances are such that Mr Kim is likely to have a better recollection of what was said by Mr Hagemrad.

409 Mr Hagemrad denied saying that cancellations in the first year of opening would be negligible: T487.3. Mr Laurence had discussed cancellations with Mr Kim on 10 October 2016 and confirmed that they would be minimal or low. It was logical for Mr Kim also to have asked the question of Mr Hagemrad. It is unlikely that Mr Hagemrad said something different to Mr Laurence. I accept Mr Kim’s evidence that Mr Hagemrad stated that cancellation would be negligible.

***29 December 2016: Disclosure document and franchise agreement***

410 In late December 2016 or early January 2017, Mr Kim received a draft franchise agreement and disclosure document. The disclosure document was dated 31 October 2016 and was in the same or substantially similar form to the Second Disclosure Document which had been sent in relation to the Balcatta franchise.

411 Clause 3.1 of the disclosure document summarised the business experience of Mr Hagemrad and Mr Husseini. No disclosure was made about existing litigation at cl 4.1. Clauses 14.3 to 14.5 of the disclosure document addressed establishment costs requiring that the details of the relevant payments be provided and “if the amount of the payment cannot easily be worked out – the upper and lower limits of the amount” be provided. Table 1 of Schedule 5 indicated establishment costs of \$653,000 to \$1,031,000 plus GST plus certain identified costs for which no specific amount was indicated – see: [205] above.

***20 January 2017: Franchisee certificate***

412 On 20 January 2017, Mr Kim executed a “Franchisee Certificate”. It was in a similar form as that for the Balcatta franchise. In the Franchisee Certificate, Mr Kim confirmed that he had received legal, accounting and business advice.

***14 March 2017: Execution of franchise agreement***

413 Mr Kim signed the Blacktown Franchise Agreement on 14 March 2017. In his first affidavit, he stated:

21 In early January 2017 we received the franchise agreement documents from the UFG Franchisor, which included a disclosure document dated 31 October 2016.

22 I read the disclosure document and in particular I relied on:

- (a) the knowledge and experience of Maz Hagemrad and Sam Hussein regarding the UFC Gym franchise operations at item 3.1; and
- (b) the establishment costs at Table 1 of Schedule 5.

414 Clause 32.8 of the draft franchise agreement contained an “Entire Agreement” clause in similar terms as previously mentioned in relation to Balcatta. This clause provided:

**32.8 Entire Agreement**

The background, Schedules and Annexures to this Agreement and any other documents expressly associated with the grant of the Franchise, such as the Disclosure Document, constitute the entire Agreement between the parties. If you believe that there are or have been oral or written representations between us and you relating to the grant of this Franchise then you must ensure that these oral or written representations are reduced to writing and you must provide such written representations to us before you execute this Agreement. We rely upon the accuracy of the representations that are reduced to writing that are contained in this Agreement before executing this Agreement.

415 This clause does not require a “Prior Representations Deed”, as did the Balcatta clause 32.8, but it does require representations to be reduced to writing. Mr Kim did not notify UFG of any such representations prior to signing the agreement.

416 Mr Kim accepted that he did not notify UFG that he was relying on any cash flow or revenue representations made by UFG when he entered into the franchise agreement: T411.39. His evidence at T411 – 412 included:

The reason, Mr Kim, that you did not notify UFG that you were relying on any cash flow or revenue representations made by it was because when you entered into the franchise agreement, you were not relying on any cash flow or revenue representations made by UFG. That’s the case, isn’t it?---I disagree with that.

You had made your own assessment of the likely financial performance of the business which you were planning to set up, and you relied on your assessment in relation to that. That’s the case, isn’t it?---I made my assessment on the information provided to me by Maz and Jason.

And you also obtained accounting and business advice as you indicated in the franchisee certificate which you signed on 20 January 2017, correct?---Yes.

And it was that accounting and business advice which you were relying on in deciding to enter into the franchise agreement. That’s the case, isn’t it?---No.

Well, you’re not saying that you did not rely at all on the accounting and business advice which you refer to in the franchising certificate. Is that correct?---No, I’m not saying that.

417 Mr Kim was cross-examined on [25] and [26] of his first affidavit, being his evidence of reliance. His evidence in cross-examination, Mr Kim stated at T413:

You knew that any income projections that had been prepared up to the sign – time of



signing the agreement – you knew that they may or may not be realised. That’s the case, isn’t it?---Yes.

You gave evidence earlier, Mr Kim, to the effect that you didn’t understand any startup costs – any forecast startup costs to be telling you what the maximum actual costs would be. You gave evidence to that effect?---Yes.

If that is the case, Mr Kim, then you must have known when you signed the franchise agreement that the actual startup costs could be larger than any forecasts that had been provided to you. That’s the case, isn’t it?---In any business like this, I understood that there would be a risk. I believe that risk to be somewhat small, given that ranges were provided, that they would be far outside that range.

And in – and knowing that risk, Mr Kim, you were still prepared to sign the franchise agreement, correct?---Yes.

## **Representations**

418 Issue 2 of the parties’ agreed list of issues concerned the Blacktown Franchise and was framed as whether Mr Hagemrad and Mr Husseinini made representations to Mr Kim to the effect that:

- (a) franchisees for UFC gyms would be able to be established for start-up costs of approximately \$600,000 for 800 to 1200 square metres: 2FASOC [31(a)], [31(b)], [37];
- (b) gross annual income for the Blacktown gym would be \$1,248,830, growing by 100 and 150 new members per month: 2FASOC [33(a)];
- (c) there would be minimal to no membership cancellations in the first year: 2FASOC [31(c)];
- (d) forecast annual gross profit would be \$1,152,670: 2FASOC [33(b)];
- (e) forecast net cash position of \$587,213 after 12 months: 2FASOC [33(c)];
- (f) establishment costs for the lease or purchase of equipment would be \$300,000 to \$500,000: 2FASOC [36(e)];
- (g) establishment costs for building, construction and fit-out costs would be \$300,000 to \$450,000: 2FASOC [36(f)].

### ***Issue 2(a)***

419 On balance, I conclude that Mr Hagemrad represented on 21 October 2016 that UFC gyms would be able to be established for start-up costs of approximately \$600,000 for gym premises of 800 to 1200 square metres. As noted below, I do not consider that Mr Kim relied on this representation when entering into the franchise agreement or guarantee.

***Issue 2(b) – (e)***

420 As to Issues 2(b), (d) and (e), Mr Laurence’s Revised Cash Flow, sent on 10 October 2016, was quite different to the draft cash flow which Mr Kim had sent on 5 October 2016. In his draft, Mr Kim projected total revenue of \$591,915, total gross profit of \$514,428 and total trade payments of \$512,153 for the first 12 months of operation, yielding net operating cash receipts of \$2,275. When he sent his draft cash flow, Mr Kim stated in his email:

... The business plan is obviously bare without knowing the site or much else about how the franchise system will run however I feel the cash flow projection is realistic.

I would be interested to know if the numbers I have are a realistic expectation.

421 The Revised Cash Flow prepared by Mr Laurence indicated total revenue of \$1,373,713 (including revenue from retail sales) for the first 12 months of operation. Mr Laurence revised the total trade payments estimated by Mr Kim from \$512,153 to \$565,457. Mr Laurence’s Revised Cash Flow showed the net operating cash receipts after 12 months at \$587,213, compared to Mr Kim’s \$2,275. Although he sought to distance himself from it, I conclude that Mr Hagemrad reviewed Mr Laurence’s Revised Cash Flow before it was sent to Mr Kim, consistently with Mr Laurence’s evidence.

422 In context, in providing the Revised Cash Flow in the way that it did, UFG was representing that gross annual revenue from membership fees for the Blacktown gym was likely to be in the order of \$1,248,830, with membership growing at between 100 and 150 new members per month as indicated in Mr Laurence’s Revised Cash Flow. It was also representing that annual gross profit was likely to be in the order of \$1,152,670 and that the net cash position was likely to be about \$587,213 after 12 months.

423 As to Issue 2(c), I accept that Mr Laurence and Mr Hagemrad represented that there would be either no or minimal cancellations in the first year. This is consistent with Mr Laurence’s Revised Cash Flow which increased Mr Kim’s assessment of new memberships and did not cater for any cancellations.

***Issue 2(f)***

424 As to [36(e)] of the 2FASOC, it was not in dispute that the disclosure document provided to Mr Kim stated, at row (b) of Table 1 of Schedule 5, that the costs for the “lease or purchase of equipment” would be \$300,000 to \$500,000.

### ***Issue 2(g)***

425 As to [36(f)] of the 2FASOC, it was not in dispute that the disclosure document provided to Mr Kim stated, at row (c) of Table 1 of Schedule 5, that establishment costs for “building, construction and fit-out costs” would be \$300,000 to \$450,000.

### **Reliance**

426 The question then is whether Mr Kim relied on any of the representations in entering into the franchise agreement and guarantee. The representations can be grouped into two broad groups:

- income representations: Issue 2 (b) to (e);
- establishment costs representations: Issue 2(a), (f) and (g).

427 The question whether Mr Kim relied on the representations turns on all of the facts assessed in context. A part of the context is Mr Kim’s experience in business, the documents he read before entering into the franchise agreement (which included the disclosure document, the franchise agreement and the franchise certificate) and the facts that he received advice from an accountant and business adviser. I have taken these matters into account.

### ***Income representations***

428 Mr Kim prepared a conservative cash flow and emailed it to Mr Hagemrad on 5 October 2016, forecasting net operating cash receipts of \$2,275.

429 Mr Hagemrad reviewed this cash flow and sent Mr Kim an email, criticising his growth forecast which contemplated only the 3% growth embedded in the forecast template. Mr Hagemrad stated that Mr Laurence will “provide you with a conservative plan to build your member numbers” and that “in our industry, just growing revenue by a mere 3% is not conducive with the business model” and that “we focus on member numbers, which in turn drives revenue”.

430 On 10 October 2016, Mr Laurence emailed his Revised Cash Flow which indicated total revenue of \$1,373,713 for the first 12 months of operation, total gross profit of \$1,152,670 and total trade payments of \$565,457, yielding net operating cash receipts of \$587,213. The Revised Cash Flow contemplated 525 members after three months and 645 members after four months and 1550 members after 12 months. It did not provide for any cancellations. Mr Laurence explained his Revised Cash Flow to Mr Kim. Mr Laurence evidently had significant experience in the gym industry.

431 I accept that Mr Kim understood Mr Laurence’s revised cash flow forecast as providing a reasonable estimation of the kind of revenue he could expect from the business should he choose to secure a franchise. Mr Kim stated in cross-examination that he made his assessment of the likely financial performance of the proposed business on the information provided to him by Mr Hagemrad and Mr Laurence: T412.6. I accept that evidence.

432 Mr Kim accepted in cross-examination that Mr Laurence’s cash flow was a forecast. He accepted that the actual figures might not be exactly the same as had been forecast and accepted that he “did not see it as a guarantee”: T404.29. Of course Mr Kim did not think that the exact amounts forecast in that cash flow would be received or that they were guaranteed, as he properly conceded. Mr Kim had no experience of owning or operating a gym. He acknowledged that he had received some accounting and business advice, consistently with the franchisee certificate he signed, but denied that he relied on that advice: T412. There was nothing in the contemporaneous documents to suggest significant reliance on that advice or to give content to it.

433 I accept that Mr Kim relied upon the Revised Cash Flow at the time he entered into the franchise agreement and guarantee to forecast likely income.

***Establishment costs representations***

434 In cross-examination, Mr Kim accepted that he read the disclosure document. His evidence at T406 included:

Would it be fair to say that, even if you were under the impression in October 2016, that establishment costs would be in the order of about \$600,000? After you read the disclosure document, you knew that UFG was estimating costs in a higher amount?---I didn’t think it was unusual that Maz would give me an optimistic figure when he was pitching the franchise to me, initially.

But my question to you is, when you had the opportunity to read the disclosure document in about January 2017, you knew that UFG was estimating costs which were higher than \$600,000?---Yes.

435 Mr Kim accepted that it was likely that he read the “boxed” section but did not recall reading it: T406.41. Mr Kim was taken to the section entitled “Important Note” at the end of Schedule 5 and stated that he did not recall reading the section but thought it likely that he would have: T407.10.

436 Mr Kim gave the following evidence in cross-examination at T407 – 408:

As a result of reading this disclosure document, Mr Kim, you knew that schedule 5 was not indicating what the startup costs would actually be. Is that correct?---I believe that it would be within that range or close to it.

You knew that it was not guaranteeing to you that the establishment costs would be in any fixed amount. Is that correct?---I did not see it as a guarantee.

And you understood that there could be variants in the actual startup costs to what was indicated in this document. Is that correct?---I assumed that the variants would be within the ranges provided.

Mr Kim, at this time, no premises had been identified for the business which you proposed to set up. Is that correct?---The one that I eventually operated in wasn't. We had been looking at a few, and John Price had sent me a few that we were considering.

And you knew that until – and you knew that any premises would have to be fitted out so that they could be carried on as a gym before the business started?---Yes.

Is that correct?---Yes.

And you knew that the actual cost of the fit-out would depend on the size, the age and the condition of the premises, correct?---Yes.

And also, at the time that you read the disclosure document in January 2017, you knew that no timeframe had been indicated for when the fit-out work would commence?---That's correct, because the – no site had been confirmed.

And you knew that the actual cost could be affected by economic – by the economic conditions at the time that the work was performed. You knew that?---I don't believe that I considered that.

...

Mr Kim, having regard to what you have just said in relation to no specific premises having been identified, you knew that it was not possible in January 2017 to indicate what the maximum actual startup costs would be?---I knew that at the time – that they were fitting out the Wetherill Park gym, because I had met Maz there and he had told me the reason we were meeting there, because they were in the process of constructing it. So my assumption was that as long as my premises was of a similar size, of a similar condition, that the prices would be estimated, well, based on what they knew on the gym that they were in the process of fitting out. I would assume that they would have known the building cost and received quotes at that time and that that was what they were providing me information based on.

But whatever they provided you, you knew that it could be no more than an estimate?---By estimate, I would – sorry, I don't – what do you mean by an estimate?

You knew that no one was assuring you or guaranteeing to you what the maximum actual startup costs would be?---Yes, I would agree with that.

437 I accept that Mr Kim relied upon paragraphs (b) and (c) of Table 1 of Schedule 5 of the disclosure document as accurately reflecting the likely upper and lower limits of the total cost of equipment (whether leased or purchased) and the total cost of fit-out. Those upper and lower limits were said to be:

- leased or purchased equipment: \$300,000 to \$500,000;

- fit-out: \$350,000 to \$450,000.

438 Mr Kim did not see the upper limit as providing a guarantee, and acknowledged that there was a risk that the upper limit might be exceeded, but he nevertheless considered that it represented the likely upper limit. Mr Kim's assessment of the risk of the upper limit being exceeded was influenced by the course of his dealings with UFG, in particular with Mr Hagemrad and Mr Laurence. Further, Mr Kim's assessment of the consequences if the upper limit in respect of start-up costs were exceeded would necessarily have been affected by the income representations, including in particular net operating cash receipts of \$587,213 indicated in the Revised Cash Flow.

439 I do not consider that Mr Kim relied on the representations as to start-up costs which pre-dated the disclosure document, including the representation made by Mr Hagemrad on 21 October 2016 that UFC gyms would be able to be established for start-up costs of approximately \$600,000 for gym premises of 800 to 1200 square metres.

### **Misleading conduct: Issues 5 to 7**

440 As with the Balcatta Franchise, Issues 5 to 7 were:

- (5) To the extent any representations were with respect to future matters, whether the respondents have adduced "evidence to the contrary" within the meaning of s 4(2) of the ACL.
- (6) To the extent any representations were with respect to a future matter, whether the respondents had reasonable grounds to make the representations.
- (7) Whether the respondents engaged misleading or deceptive conduct, in contravention of s 18 of the ACL in respect of any:
  - (a) representations with respect to a future matter; and
  - (b) the balance of any representations made.

441 These issues can be addressed together.

442 In summary, I have found that Mr Kim relied on the following representations:

- (a) Income representations:
  - Issue 2(b): gross annual income for the Blacktown gym was likely to be in the order of \$1,248,830, with membership growing at between 100 and 150 new members per month.
  - Issue 2(c): there would be either no or minimal cancellations in the first year.

- Issue 2(d): annual gross profit was likely to be in the order of \$1,152,670.
- Issue 2(e): the net cash position was likely to be about \$587,213 after 12 months.

(b) Establishment costs representations:

- Issue 2(f): the costs for the lease or purchase of equipment was likely to be within the range \$300,000 to \$500,000 as provided at row (b) of Table 1 of Schedule 5 of the disclosure document.
- Issue 2(g): the costs for building, construction and fit-out costs was likely to be \$300,000 to \$450,000 as provided at row (c) of Table 1 of Schedule 5 of the disclosure document.

443 Each of these is a representation as to a future matter.

### ***Income representations***

444 The Revised Cash Flow more than doubled the gross income from Mr Kim’s forecast in his draft cash flow. The Revised Cash Flow contemplated 1550 members after 12 months, with no cancellations.

445 It was submitted that Mr Laurence’s experience in the fitness industry was extensive and that “the critical input from Mr Laurence into [the cash flow] is what allowed for growth of the membership”: T680.17. It was noted in closing submissions that Mr Laurence set out in his affidavit that he allowed for two sales advisors with a target of recruiting 50 members per month and a general manager with a target of recruiting about 25 members per month, which was said to explain why, if you allow a two-month pre-sale period, you have 250 members in the first month, and that the growth of the membership that followed was based on those targets: T680.

446 As at October 2016, Mr Laurence had only recently commenced working with UFG. No UFC franchise gym had yet begun operations in Australia. Mr Laurence accepted that UFG gyms were different to others, involving a range of martial arts coaches, as well as regular personal trainers, and that – before working with UFG – he had not had experience in operating UFC style gyms: T450. He had been to the US in late May 2016 for a week for training.

447 Neither Mr Hagemrad nor Mr Laurence gave direct evidence that they considered it realistic for a gym of the size being discussed to have 1550 members after 12 months. Mr Laurence gave direct evidence in his affidavit that he considered achieving 250 members in the pre-sale

period “reasonable based on my experience of opening a new gym”, but he did not give evidence to the effect that he considered the remaining growth to 1550 members to be reasonable. Mr Laurence confirmed in cross-examination that an absence of cancellations was inconsistent with his experience in relation to cancellations being not uncommon in the gym industry: T449.28. This applies to the forecast of the initial 250 members during the pre-sale period and first month, and to the total of 1550 members after 12 months.

448 It might be noted that the Balcatta cash flows of 9 and 17 June 2016 had adopted maximum member numbers of 800 after 12 months. Neither Mr Hussein nor Mr Hagemrad had suggested that these numbers were too few in relation to the Balcatta franchise.

449 Mr Laurence did not expressly state that the numbers he forecast in his Revised Cash Flow were consistent with particular experiences or state why the forecast was considered to be appropriate having regard to previous experiences. There was no suggestion that Mr Laurence had considered the location which Mr Kim had nominated in his business plan or assessed whether the proposed gym could reasonably expect the member numbers or growth he forecast in that location, having regard to relevant matters including existing competition.

450 Even if the forecast numbers of new members had some basis in Mr Laurence’s experience with different gym models (which was not clearly explained by the evidence), it was not reasonable for Mr Laurence’s cash flow to assume no cancellations. Mr Laurence accepted that he stated to Mr Kim that cancellations would be low. Mr Laurence’s affidavit evidence that he considered cancellations would be low because the memberships were fixed term memberships does not make it reasonable not to cater for any cancellations. Nor did his evidence expressly state that his experience of substantial cancellations was different in relation to fixed term memberships or how. Neither Mr Hagemrad nor Mr Laurence informed Mr Kim of the cancellations experienced at Wetherill Park after it opened on 5 December 2016 at any before Mr Kim executed the franchise agreement and guarantee on 14 March 2017.

451 The respondents’ evidence did not explain why it was reasonable to forecast member numbers expanding well above one person per square metre. In cross-examination, Mr Hagemrad accepted that, in the context of the events concerning the Balcatta Franchise, he stated to one or more of Mr K Girgis, Mr S Girgis and Mr Chau that one could work with one person per square metre: T502.44. In re-examination, he stated at T556:

You also gave evidence yesterday about becoming aware of an industry rule of thumb in about – in the period about April to June 2016, and that rule of thumb being one



person per square metre of the size of the gym. Do you recall giving that evidence?---  
I do.

What did you understand by that rule of thumb when you became aware of it?---So, firstly, the rule of thumb is actually one per square metre to a maximum of two per square metre that's used. It's a budgeting tool used to apply to, if you're assessing real estate space – real estate sites, sorry, to understand what your budget's forecast can be built to, whether, you know, sites are viable and so forth.

452 Mr Hagemrad had the opportunity of conferring with his legal advisers after cross-examination and before re-examination. The evidence set out above was the first suggestion Mr Hagemrad had made of working with more than one person per square metre.

453 Even if it was reasonable to work with member numbers above one person per square metre, it was not explained why that was considered an appropriate ratio when forecasting what Mr Hagemrad had described to Mr Kim as a “conservative plan to build your member numbers”.

454 The evidence adduced was insufficient to constitute “evidence to the contrary” for the purposes of s 4(2) of the ACL. In particular, it was not possible to determine from the evidence given whether Mr Laurence or Mr Hagemrad (who approved Mr Laurence's Revised Cash Flow) considered the membership growth to 1550 members to be reasonable or what had actually been taken into account in taking that view apart from a generalised assertion of “experience” in the gym industry. It follows that Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1).

455 In any event, I would have held that the Blacktown applicants had established that there were not reasonable grounds for making the income representations. The respondents did not have reasonable grounds to assume the member numbers assumed or that there would be no cancellations.

### ***Establishment costs representations***

456 The Blacktown disclosure document dated 31 October 2016 (being materially the same as the Second Disclosure Document) was sent to Mr Kim in late December 2016 or early January 2017. It represented that the costs for the “lease or purchase of equipment” would be \$300,000 to \$500,000 as provided at row (b) of Table 1 of Schedule 5. That is likely to have been meant as, and understood as referring to, a GST exclusive price.

457 For reasons given in relation to the Balcatta Franchise, whether the range was GST inclusive or GST exclusive, the representation was misleading and deceptive – see: [350] to [361] above.

458 The Blacktown disclosure document also represented that “building, construction and fit-out costs” would be \$300,000 to \$450,000 as provided at row (c) of Table 1 of Schedule 5 of the disclosure document. Again, in context, this was likely a reference to a GST exclusive price. For reasons given in relation to the Balcatta Franchise, whether the range was GST inclusive or GST exclusive, the representation was misleading and deceptive – see: [362] to [368] above.

459 It follows that the establishment costs representations which were conveyed were misleading and deceptive.

### ***The conduct***

460 I am satisfied, after considering the representations made in the context of the whole course of events, that Mr Hagemrad and Mr Hussein, and through them UFG, engaged in misleading conduct in contravention of s 18 of the ACL.

## **LIABILITY: CASTLE HILL FRANCHISE**

### **Factual Background**

#### ***12 June 2017: Meeting***

461 On 12 June 2017, there was a meeting between Mr Mirdjonov, Mr Price and Mr Hagemrad. In his first affidavit, Mr Mirdjonov stated:

7 During the meeting we had a discussion to the effect of the following, noting the more important matters that we discussed:

Maz: We have a “Proven Business Model” that works in Australia.

Laz: I have a small privately opened gym “Spectrum Fitness” and I have been struggling with this business. I am interested in UFC Gym based on your website that I have found and possibly in investing in the brand since it looks like I can make returns quickly with minimal risk.

...

Maz: We generally prefer that Franchise partners don’t get involved in day to day operations. We will take care of this. Will you be involved in gym operations?

Laz: Yes.

John: After spending \$1 million on the gym you probably want to do it yourself.

Laz: I would like to change my career from IT to running my own gym.

Maz: I have no objections for you operating your own gym, as long as you follow our proven procedures.

- John: How do you feel about following our procedures, as you have been running your own gym based on your own decisions but here you have to follow our processes?
- Laz: I will follow everything you want, to make my club as successful as yours. What is the current status of your existing gyms? What is the break-even point?
- Maz: UFC gyms' break-even point is around 600 to 700 members. The majority of members will be obtained during presales for the gym, which means that once you open your doors you are either already at break-even or not far off it. All UFC gyms have opened to date are doing really well, and are growing fast. Our clubs also make a lot of money off their merchandise sales due to the UFC brand name.
- Laz: How much money do I need to open UFC gym?
- John: This depends on the site, but you should be looking at a figure around \$1 million to \$1.2 million. This is [sic] includes the UFG gym equipment which should be around \$200,000 and the first-year operating costs. We recommend that you buy this equipment outright, but we are also working on vendors that may be able to finance this equipment.
- Laz: Ok so I have around \$1 million and I will finance the \$200k equipment, that should be fine. I am very interested in becoming a UFC gym franchisee.
- Maz: As next steps, we will send you templates to complete which are a business plan and financial model. Jason Laurence who is our Operations Manager, will be assisting you with completing these. Once you have completed this, the documents will be reviewed and approved by me and then sent to UFC gym US head office for your application to be approved to become a franchisee.

462 In his affidavit, Mr Price stated:

- 5 I refer to paragraph 7 of the Mirdjonov affidavit, and make the following comments:
- (a) I agree that I said words to the effect of “after spending \$1 million plus on the gym you probably want to do it yourself” and “you have to follow UFG’s processes”.
  - (b) In response to the question “how much money do I need to open a UFC Gym?”, I said words to the effect that “it depends on the site, however based on our recent experience, you should expect a figure of around \$1 to \$1.2 million to open, excluding GST, and excluding strength and cardio equipment, but including our UFC Gym branded equipment”. I deny that I said words to the effect that the \$1 to \$1.2 million “includes first year operating costs”.
  - (c) I deny that Laziz said words to the effect that “I have \$1 million and will finance \$200k”.
  - (d) I recall Maz saying words to the effect “you should target to sell around 800 memberships in pre-sale to get as many members as possible before you open”.

463 Although he was not present at the meeting, in his affidavit Mr Laurence said:

16 I also disagree with Laziz concerning his comments about his knowledge of gyms. Whilst Laziz had not been a UFC franchisee I recall he said to me words to the effect “I know what I am doing as I have run and ow[n]ed a gym before. I just need the numbers for presell for memberships”. To the best of my recollection this conversation occurred in early July 2017.

464 In his second affidavit, Mr Mirdjonov stated:

5 As to paragraph 5(a) John Price did not say “plus”. He said that was about \$1 million.

6 As to paragraph 5(b), Mr Price did not say “excluding GST”. He did not speak in figures excluding GST. He said words to the effect that there would be \$1 million to \$1.2 million out of pocket expenses including operation expenses and gym equipment.

7 During this meeting John Price did not say “strength and cardio equipment”.

8 As to paragraph 5(c), after my comment about financing Mr Price said, “We recommend you buy this equipment outright, but we are also working on vendors that may be able to finance this equipment”.

9 I deny paragraph 5(d). We did not discuss presales of 800 memberships. We discussed a break-even point of about 600 to 700 members. At a UFG Christmas party Maz gave a speech repeated this figure of 600 to 700 members.

...

17 As to paragraph 16, I said to Mr Laurence words to the effect that I know how to run presales, but since I am new to UFC Gym brand I do not know their business model or performance, I needed to rely on their experience.

465 In his first affidavit, Mr Hagemrad stated:

50 I refer to paragraph 7 of the Mirdjonov affidavit and make the following comments:

(a) I agree that I said words to the effect that “UFG has a proven business model”.

(b) I cannot recall whether Laziz said words to the effect that “he would make returns quickly with minimal risk”, however if he had said words to that effect, I believe I would recall it as I don’t consider such a statement to be accurate about any gym business.

(c) I do not recall specifically advertising UFC Gyms on the website referred to by Laziz, however it is possible that the UFC branded gyms may have been advertised on that website as part of a franchising expo, which would have provided a complimentary listing.

(d) I deny saying words to the effect that “we will take care of” the day to day operations of the franchise. I did say words to the effect that UFG prefers franchise partners to focus on the administration side of the business, however the franchise partners would need to recruit an experienced manager for the day to day operations of the business and

good sales staff. I did say words to the effect “we prefer franchise partners not to focus on the construction and focus on the presale. Our team handles the construction process”.

- (e) I deny that I said words to the effect that “the UFC Gyms’ breakeven point is around 600 to 700 members”. I did say to Laziz words to the effect that “based on the UFC Gyms that are currently in operation and are following our processes, the breakeven number is approximately 800 to 850 members”.
- (f) I deny saying that “the majority of members will be obtained during presales for the gym, which means that once you open your doors you are either already at break-even or not far off it”. I did say words to the effect that “the objective of the pre-sale is to maximise member numbers in order to open as close to break-even as possible. However, the average dues in pre-sale are substantially lower than full operating memberships, and therefore could impact your breakeven number.” This is a statement I have made about memberships to all prospective franchisees. Memberships in presale are considered foundation memberships and are sold at a discount to encourage customers to purchase at that time, rather than waiting for the gym to open.
- (g) I deny saying “all UFC gyms are doing really well, and are growing fast”. I did say words to the effect that “most clubs are performing well based on the amount of time they have been open”.
- (h) I deny saying words to the effect that “our clubs make a lot of money off merchandise sales due to the UFC brand name”. I did say words to the effect that “merchandise sales for UFC Gyms are much higher than other gym brands due to the UFC brand”.
- (i) I deny that I said words to the effect that once the business plan and financial model were complete, they would be “approved by me”. I did however say that these documents would need to be “approved by the Board”, as I am not solely responsible for this approval.

466 In his second affidavit, Mr Mirdjonov stated:

- 19 As to paragraph 50(d) [of Mr Hagemrad’s affidavit], his exact words were, “We will take care of day to day operations”. Maz said he expected me to recruit a good General Manager, and that UFC would help me recruit and would work with the General Manager on running the club and recruiting other staff. He did not make the comments regarding a focus on construction and presales.
- 20 I deny paragraph 50(e). Maz stated a figure of 600 to 700 members as the “break even” figure for most UFC gyms. He did not say that I needed 800 members to be even. As mentioned above, Maz stated this figure of 600 to 700 members during a speech at a UFC Christmas party. At a later time I also recall him saying that the Penrith break even figure was 750 members.
- 21 I deny paragraph 50(f).
- 22 I deny paragraph 50(g). Maz said words to the effect that, “All UFC gyms were doing really well and growing fast”. At this meeting he said repeatedly words to the effect that UFC Gym was a very successful franchise in Australia.

23 I deny paragraph 50(h). Maz did not say these words.

24 I deny paragraph 50(i). Maz also said words to the effect that, “I am happy with everything on the forecast model and business plan, except long presales”. Maz said that he was happy to send it to the US for approval. Maz did not say that the figures needed to be approved by the board and did not mention a “board”.

467 In cross-examination, Mr Price agreed that Mr Hagemrad said to Mr Mirdjonov that UFG had a proven business model that works in Australia: T566.34. He agreed that Mirdjonov had said that he had a small privately-owned gym called Spectrum Fitness and that he was looking for a new opportunity with UFC: T566. He agreed that Mr Mirdjonov said that he would like to be involved in the running of his club and that he responded by saying something similar to: “After spending a million dollars on the gym, you probably want to do it yourself”.

468 Mr Price said he could not remember whether Mr Hagemrad stated that the breakeven point was around 600 to 700 members but did not deny that it was said. Mr Price accepted that Mr Hagemrad talked about the pre-sales process but denied that Mr Hagemrad had said that “once you open your doors, you should already be at breakeven or not far from it”: T567.27.

469 Mr Price thought it possible that Mr Hagemrad had said that the UFC gyms that had opened to date were doing really well: T567.

470 Mr Price’s evidence included at T567.37:

Mr Mirdjonov asked you how much money you needed to open the UFC GYM. Do you remember that?---Yes.

And your response was, “It depends on the site, but you should be looking at a figure about 1 million to 1.2 million”?---Yes.

In terms of equipment, you said that, “We” – I think referring to UFC franchisor, “recommend that you buy the equipment outright”?---Yes.

But you had some vendors who may be able to equipment finance?---Yes.

471 Mr Price was challenged on his version of what was said in response to Mr Mirdjonov’s question as to how much money he needed to open a UFC Gym. As noted above, Mr Price’s evidence was that he said words to the effect that “it depends on the site, however based on our recent experience, you should expect a figure of around \$1 to \$1.2 million to open, excluding GST, and excluding strength and cardio equipment, but including our UFC Gym branded equipment” and that he did not say that the \$1 to \$1.2 million “includes first year operating costs”.

472 The essence of the challenge was that Mr Price's response was unlikely because; (a) Mr Mirdjonov was evidently asking for an identified amount; (b) Mr Price's evidence as to what he responded was that he gave an amount, together with a series of qualifications; (c) this would have left Mr Mirdjonov unable to determine the relevant amount.

473 Mr Mirdjonov was cross-examined about what Mr Price said about the cost of opening being in the range of \$1 to \$1.2 million. Mr Mirdjonov did not accept that Mr Price's account of what he said was accurate, at least in full: T324. He accepted that an amount of \$1.2 million was mentioned, but was adamant that nothing was said about GST and that nothing was said about strength and cardio equipment: T324.11. Mr Mirdjonov stated that he did not understand "strength and cardio equipment" to be a reference to Life Fitness equipment at the time: T325.8.

474 Mr Mirdjonov was also challenged in cross-examination about whether Mr Hagemrad had stated that the breakeven point was around 600 to 700 members: T317. It was put to him that Mr Hagemrad said that the breakeven number was 800 to 850 members, Mr Mirdjonov did not accept this: T318.22.

475 After the meeting, but on the same day, 12 June 2017, Mr Price sent an email to Mr Mirdjonov attaching templates for a business plan and a 12-month cash flow. The business plan required the prospective franchisee to assess any potential weaknesses of and threats to the proposed franchise business. It was in a similar form to that which had been sent in relation to the Balcatta franchise. The cash flow template was an unpopulated excel document entitled "12 Month Cash Flow Worksheet". It was in similar form to that which had been sent in relation to both the Balcatta and Blacktown franchises.

### ***13 June 2017: Email***

476 On 13 June 2017, Mr Laurence sent an email to Mr Mirdjonov, attaching a "document ... that will help when building your business plan". The affidavit evidence was unclear as to what was attached to this email, with Mr Laurence and Mr Mirdjonov saying inconsistent things. The question was ultimately resolved by the tender of agreed printouts of emails of 13 June 2017, 2 July 2017, 7 July 2017 (2 emails), 10 July 2017 (2 emails) and 20 July 2017 and some of the attachments: Exhibit 6.

477 Later, electronic versions of those emails with all attachments were provided.

478 Mr Laurence's evidence was that he sent a spreadsheet which had been created by him "with input from Maz based on learnings from UFC Wetherill Park" and his previous experience.

The excel spreadsheet attached to the email of 13 June 2017 contained a number of tabs. It was in similar form to those discussed below.

479 In his first affidavit, Mr Mirdjonov's stated that, after receiving this email, he "requested Jason [Laurence] to provide me real Financials and Business Plans based on the performance of existing clubs like Wetherill Park". He stated these were provided to him and that Mr Laurence stated to him "that the projections were based on the Wetherill Park figures". I conclude that the relevant documents are those referred to next, provided by Mr Laurence in his email of 2 July 2017.

### ***2 July 2017: Emails between Mr Mirdjonov and Mr Laurence***

480 On 2 July 2017, Mr Mirdjonov sent an email to Mr Laurence posing a number of questions to assist him completing the business plan. Mr Laurence responded the same day, by annotating Mr Mirdjonov's email in red font (indicated in **bold** below). The annotated email states (errors as per original):

Hi Jason, I hope you well,

Just got back from overseas with a little delay, I was trying to give a crack for business plan but, I will need the following details to complete it at my best:

0. Vision, Mission, Values - is there standard UFC statements I can use ?

**I have attached our brand Maxims they will point you in the right direction**

1. Without Location I wont be able to complete SWOT? I need to understand what is the minimum requirements for walk by traffic, demographics, population count, based on demographics study and local competition will be able to find an opportunities and motives for the business.

**With this one, please think of your ideal location and that you have been approved to opening up there. We look for drive by parking and great frontage high roof space. You can get the other stuff from Wetherill Park doc attached**

2. What is the main niche for UFC GYM and Point of difference- I will need some help with marketing strategies, etc.

**Tell us what you think it will be for you as a Franchise Partner?**

3. Appart from memberships Whats are the services, products and their description that usually provided atthe gym?

**Retail sales and Private coaching.**

4. What is the model for personal trainers - percentage or rent, would it matter what I choose one?

**See forecast document attached**



It would've been fantastic if you could send me already pre populated Business plan for one of the existing one, please let me know if you have information above, I want to move with this as fast as possible.

**See attached Wetherill Park BP and Forecast Template I am available to discuss any information both documents should help you to complete your personal plan**

Attached to Mr Laurence's email was a word document being the Wetherill Park Business Plan, an excel spreadsheet being a "Financial Model" and a PDF of a UFC brand poster.

The first sheet of the Financial Model spreadsheet was called "Start Up Cost" and provided:

Estimated Set Up Costs + G.S.T	
Item	Cost
Legal Fees	\$5,000.00
Council (DA FEES)	\$3,000.00
Franchise Fee	\$60,000.00
Flooring and Fit out Cost	\$550,000.00
Insurance	\$5,000.00
Internal + External Signs	\$50,000.00
Fixtures and furnishings	\$4,011.12
Office/IT/Computers/software	\$4,000.00
Printing and stationery	\$1,000.00
Uniforms	\$300.00
Unanticipated expenses	\$2,000.00
Working capital	\$70,000.00
Audio / Security System + Installation	\$50,000.00
Equipment Deposit	t.b.a
<b>Total</b>	<b>\$804,311.12</b>

Note: Fitout Cost: \$550 - \$850 + GST dependant the Mo footprint

Items can be financed Secured against assets or paid outright

Bank Guarantee	T.B.C
Equipment (Octagon and Bag Rack)	\$195,000.00
Life Fitness Equipment	\$290,000.00

<b>Life Fitness Monthly Repayment</b>	With 10% deposit
On Loan \$345,000 @ 10.5% over 48 months =	\$9,436
On Loan \$550,000 @ 15% Deposit Required	\$12,550

This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however highlights the opportunity.

Retail Merchandising equipment UFC	\$	3,668.94
Juice Bar Equipment UFC	\$	9,986.65
Marketing Frame UFC	\$	1,100.00
Random Furniture UFC	\$	4,011.12
UFC Gym racks	\$	10,129.31
Gym Equipment	\$	22,817.29

The "estimated set up costs" plus the equipment specified on the right hand side of the page (but excluding the equipment at the bottom left of the page) total  $\$804,311.12 + \$195,000 + \$290,000 = \$1,289,311.12$ . If one excludes the Life Fitness equipment at \$290,000, the total is \$999,311.12. The equipment at the bottom left of the pages was not addressed in the evidence and the cross-examination of the witnesses proceeded without any reference to it.

The next two sheets of the excel spreadsheet provided a financial model setting out cash flows for a gym for the first and second year. The first year included two months of pre-sales before operations in which it gained 200 members in each of those two months.

485 The “1<sup>st</sup> Year” sheet provided:


UFC GYM													
Year 1. Financial Model 2017/18													
CLUB NAME:													
	-2	-1	1	2	3	4	5	6	7	8	9	10	
New Members	200	200	150	150	140	130	130	125	120	120	120	120	
Cancellations				40	27	31	35	35	43	45	49	52	
NET				110	113	99	95	86	77	74	71	68	754
# DIRECT DEBIT MEMBERS	200	200	550	660	773	872	967	1,052	1,130	1,204	1,275	1,344	1,470
TOTAL DD VALUE	\$85		\$42,075	\$50,490	\$59,155	\$66,704	\$73,948	\$80,515	\$86,435	\$92,114	\$97,563	\$102,792	\$171,792
PIF Membership Sales	\$1,000		\$15,000	\$15,000	\$11,000	\$11,000	\$11,000	\$11,000	\$11,000	\$11,000	\$11,000	\$11,000	\$118,000
Admin Fee Income @ \$49	\$49		\$29,400	\$7,350	\$6,860	\$6,370	\$6,370	\$6,125	\$5,880	\$5,880	\$5,880	\$5,880	\$85,995
Private Coaching Income		\$0	\$0	\$0	\$4,000	\$5,000	\$6,000	\$7,000	\$7,000	\$7,000	\$7,000	\$7,000	\$50,000
Retail Sales			\$4,000	\$5,000	\$5,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$42,000
Other club income			\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$20,000
TOTAL GROSS INCOME			\$90,475	\$77,840	\$86,015	\$93,074	\$101,318	\$108,640	\$114,315	\$119,984	\$125,443	\$130,672	\$1,047,787
MONTHLY EXPENSES & %													
Fixed Monthly - Operating	Annual Rental												
A. Rent Per Month / Year One			\$0	\$0	\$0	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$175,000.0
C. Life Fitness Equipment	\$345,000		\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$6,400	\$94,000.0
D. Insurance		\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$18,000.0
E. Royalty Fee @ 10%			\$9,048	\$7,784	\$8,602	\$9,307	\$10,132	\$10,864	\$11,431	\$11,999	\$12,544	\$13,067	\$104,778.7
F. Group Marketing @ 2%			\$1,810	\$1,557	\$1,720	\$1,861	\$2,029	\$2,173	\$2,288	\$2,400	\$2,509	\$2,613	\$20,955.7
G. DS Transaction Fees			\$5,500	\$1,500	\$1,400	\$1,300	\$1,300	\$1,250	\$1,200	\$1,200	\$1,200	\$1,200	\$17,050.0
H. G&C Loan			\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$6,000	\$60,000.0
Sub-total %		\$1,500	\$27,257	\$21,741	\$22,622	\$48,369	\$48,358	\$50,187	\$50,818	\$51,499	\$52,153	\$52,781	\$429,784.4
Non/Fixed Monthly Operating													
Payroll & Superannuation		\$12,000	\$15,000	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$297,877
Commissions	\$25		\$12,000	\$3,750	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$35,750
PC Contractor Payments	\$25		\$4,500	\$4,500	\$4,550	\$4,550	\$4,550	\$4,550	\$4,550	\$4,550	\$4,550	\$4,550	\$45,400
Staff Uniforms			\$500	\$200	\$200	\$100	\$0	\$0	\$0	\$0	\$0	\$0	\$1,000
Merchandise cost			\$5,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$23,000
Waste Energy			\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$35,000
Foritel			\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$4,000
Cleaning Contractor			\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$18,000
Marketing		\$6,000	\$6,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$40,500
Telephone and Internet		\$300	\$300	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$5,100
Program Fees (ISC)			\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$1,250
Maintenance /Repairs/Painting			\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$5,000
Security			\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$500
Schwab Gladstone		\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$6,600
Office Supplies		\$100	\$100	\$600	\$600	\$300	\$100	\$100	\$100	\$100	\$100	\$100	\$2,400
Printing			\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$6,000
Bank Fees			\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$2,000
Waste Bin Services			\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Other			\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$5,000
Sub-total %		\$18,950	\$21,950	\$61,363	\$49,813	\$48,313	\$46,513	\$47,913	\$47,913	\$47,913	\$47,913	\$47,913	\$47,913
TOTAL MONTHLY %		\$20,450	\$23,450	\$88,620	\$71,553	\$70,934	\$68,882	\$69,271	\$68,100	\$68,730	\$69,412	\$70,066	\$100,683
Current Club Profit / Loss		-\$20,450	-\$23,450	\$1,855	\$6,287	\$15,081	-\$1,807	\$4,047	\$10,541	\$15,584	\$20,582	\$25,377	\$29,979
This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however highlights the opportunity.													
Start Of Rent													

486 A number of observations should be made:

- The first two months (-2 and -1) are pre-sale months in which it is contemplated that 400 members are obtained and the gym has a net negative cash flow. The last ten months (1 to 10) are months after the gym has opened.
- In the first month after opening (month 1) a further 150 members are obtained and the model contemplates a profit. At this point there are 550 members. However, month 1 is the first month of a three month rent holiday. If rent were factored in, the gym would remain unprofitable in month 1.
- The applicants submitted that the model contemplates that, at the end of the first year, there would be 1,470 new members, including 1,344 “DD” (Direct Debit) members. The applicants submitted that the total of 1,470 was a reference to both “DD” members and “PIF” or “Paid in Full” members. This was not disputed by the respondents who were in a better position to know given it was their model.

- Cancellations begin in month 2 (the second month after opening) at 5.71% of the total DD members contemplated by the end of month 2, namely 700 DD members. In the last month of the year (month 10), the cancellation rate is forecast as 3.84% of the total DD members contemplated by the end of month 10, namely 1344 DD members. The model contemplates an average cancellation rate of about 3% per month in the first year and 4% per month in the second year.
- Life Fitness equipment is assumed to be \$345,000 and is included as an operating expense at \$9,400 a month, starting in the first month of opening.
- After rent becomes payable, namely for month 4 after opening, the gym returns to net negative cash flows for that month. The gym returns to net positive cash flows again in month 5.
- Gross income for the first year was forecast as \$1,047,787. Profit for the first year was forecast as \$83,626.

487 The “2<sup>nd</sup> Year” sheet provided:

<div>  </div>														
CLUB NAME:														
	1	2	3	4	5	6	7	8	9	10	11	12		
New Members	20	60	60	60	60	60	60	60	60	60	60	60	60	880
Cancellations		55	56	57	58	59	60	61	61	62	63	64		657
Net		25	24	23	22	21	20	19	19	18	17	16		223
total members		1,364	1,388	1,412	1,435	1,457	1,478	1,498	1,517	1,536	1,554	1,571	1,587	1690 Total Members
TOTAL DD VALUE	\$100	\$122,732	\$124,961	\$127,100	\$129,153	\$131,122	\$133,012	\$134,825	\$136,564	\$138,233	\$139,835	\$141,372	\$142,846	\$1,601,754
PIF Membership Sales	\$1,000	\$2,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000	\$90,000
Admin Fee Income @ \$40	\$40	\$960	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$44,100
Private Coaching Income	\$0,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$6,067	\$72,800
Retail Sales	\$4,000	\$5,000	\$5,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$50,000
Other club income	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$24,000
TOTAL GROSS INCOME		\$133,778	\$147,948	\$150,087	\$151,139	\$153,109	\$154,998	\$156,811	\$158,551	\$160,220	\$161,822	\$163,358	\$164,833	\$1,858,654
MONTHLY EXPENSES & %														
Fixed Monthly - Operating	Annual Rental													
A. Rent Per Month / Year Use	\$300,000	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$25,750	\$309,000.0
C. Life Fitness Equipment	\$345,000	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$9,400	\$112,800.0
D. Insurance		\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$1,500	\$18,000.0
E. Franchise Fee @10%		\$13,577.85	\$14,794.78	\$15,008.69	\$15,113.94	\$15,310.87	\$15,499.82	\$15,681.13	\$15,856.09	\$16,022.00	\$16,182.16	\$16,336.83	\$16,483.27	\$185,865.4
F. Group Marketing @ 2%		\$2,716	\$2,859	\$3,002	\$3,023	\$3,062	\$3,100	\$3,136	\$3,171	\$3,204	\$3,236	\$3,267	\$3,297	\$37,173.1
G. DS Transaction Fees		\$980	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$3,920	\$39,200.0
Sub-total %		\$52,943	\$54,404	\$54,660	\$54,787	\$55,023	\$55,250	\$55,467	\$55,676	\$55,876	\$56,069	\$56,253	\$56,430	\$662,838.5
Non/Fixed Monthly Operating														
Payroll & Superannuation		\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$27,088	\$325,052.0
Commissions	\$25	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$30,000.0
PC Contractor Payments		\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$12,000.0
Staff Uniforms		\$0	\$0	\$0	\$300	\$0	\$0	\$0	\$300	\$0	\$0	\$0	\$300	\$900.0
Merchandise cost		\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$24,000.0
Origin Energy		\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	\$42,000.0
Foxtel		\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$400	\$4,800.0
Cleaning Contractor		\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$1,800	\$21,600.0
Marketing		\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$36,000.0
Telephone and Internet		\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$450	\$5,400.0
Program Fees (TBC)		\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$125	\$1,500.0
Maintenance /Repairs/Painting		\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$6,000.0
Security		\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$600.0
Club Management Software		\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$550	\$6,600.0
Office Supplies		\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$1,200.0
Printing		\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$800	\$9,600.0
Bank Fees		\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$3,600.0
Wast Bin Services		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0.0
Other		\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$500	\$6,000.0
Sub-total %		\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$44,463	\$534,452.0
TOTAL MONTHLY %		\$97,406	\$98,868	\$99,123	\$99,549	\$99,486	\$99,712	\$99,938	\$100,439	\$100,339	\$100,531	\$100,716	\$101,193	\$1,197,290.5
Current Club Profit / Loss		\$38,372	\$49,081	\$50,964	\$51,590	\$53,623	\$55,286	\$56,881	\$58,112	\$59,881	\$61,290	\$62,643	\$63,640	\$661,363.7

This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however highlights the opportunity.

488 A number of observations can be made:

- Except in month 1 of the second year, the model contemplates 80 new members per month.
- The model contemplates a cancellation rate of about 4% of total members each month in the second year.
- According to the applicants, the model contemplates that, at the end of the two year period, there would be 1,690 new members, including 1,587 “DD” members. This was not disputed by the respondents.
- Gross income for the second year was forecast as \$1,858,654. Total expenses for the second year were forecast as \$1,197,290.5 and profit was forecast as \$661,363.70.

489 The fourth sheet of the excel spreadsheet, entitled “Private Coaches”, calculated the rent which could be charged to private coaches. The fifth sheet was entitled “Payroll” and contained calculations for staff. The sixth and final sheet was entitled “Membership List” and set out the various member fees which might be charged.

490 As mentioned, Mr Laurence also sent the Wetherill Park Business Plan as an attachment to his email of 2 July 2017. This Business Plan states that it was prepared by Mr Laurence and is dated 20 September 2016.

***7 July 2017: Email from Mr Mirdjonov***

491 On 7 July 2017 at 10:56am, Mr Mirdjonov sent an email to Mr Laurence stating that he, Mr Mirdjonov, had “used your marketing plan ... and P/L forecast to complete required documents” and asking him, Mr Laurence, to “review and let me know what you think”. He attached a Financial Model and a Business Plan.

492 On 7 July 2017 at 11:58am, Mr Mirdjonov sent an updated “P/L forecast” to Mr Laurence, being an updated Financial Model.

493 Consistently with the first 7 July 2017 email, and his evidence in cross-examination, when the “Wetherill Park BP and Forecast Template” attached to Mr Laurence’s 2 July 2017 email are compared to the documents which Mr Mirdjonov attached to his 7 July 2017 emails, it is clear that Mr Mirdjonov has simply made various changes to the documents he had been sent.



494 Mr Mirdjonov's spreadsheet included the following on the first sheet, being the "Start Up Cost" tab:

Estimated Set Up Costs + G.S.T	
Item	Cost
Legal Fees	\$5,000.00
Council (DA FEES)	\$6,000.00
Franchise Fee	\$60,000.00
Flooring and Fit out Cost	\$550,000.00
Insurance	\$7,000.00
Internal + External Signs	\$50,000.00
Fixtures and furnishings	\$4,011.12
Office/IT/Computers/software	\$4,000.00
Printing and stationery	\$1,000.00
Uniforms	\$700.00
Unanticipated expenses	\$50,000.00
Working capital	\$200,000.00
Audio / Security System + Installation	\$50,000.00
Equipment Deposit	\$50,000.00
<b>Total</b>	<b>\$1,037,711.12</b>

Note: Fitout Cost: \$50 + \$50 + GST dependant the Mr footprint

Items can be financed Secured against assets or paid outright	
Bank Guarantee	\$0.00
Equipment (Octagon and Bag Rack)	\$195,000.00
Life Fitness Equipment	\$290,000.00

Life Fitness Monthly Repayment	With 10% deposit
On Loan \$345,000 @ 10.5% over 48 months =	\$9,436
On Loan \$550,000 @ 15% Deposit Required	\$12,550

This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however highlights the opportunity.

Retail Merchandising equipment UFC	\$ 3,668.94
Juice Bar Equipment UFC	\$ 9,986.65
Marketing Frame UFC	\$ 1,100.00
Random Furniture UFC	\$ 4,011.12
UFC Gym racks	\$ 10,129.31
Gym Equipment	\$ 22,817.29

495 The main differences in the first sheet between what Mr Laurence had sent and Mr Mirdjonov's version are: (a) an increase in working capital from \$70,000 to \$200,000; (b) an increase in "unanticipated expenses" from \$2,000 to \$50,000; and (c) the insertion of an amount of \$50,000 for "equipment deposit".

496 The "estimated set up costs" plus all equipment total \$1,037,711.12 + \$195,000 + \$290,000 = \$1,522,711.12. If one excludes the Life Fitness equipment, the total is \$1,232,711.12. These calculations ignore the equipment at the bottom left of the page.

497 Mr Mirdjonov had amended the "Year 1" financial model in a number of ways, including to: add an additional two months of pre-sales to achieve the contemplated 400 new members before opening; and to allow for four months' rent holiday and three months at half rent. The net DD member numbers (taking into account cancellations) remained the same as had been contemplated in Mr Laurence's model. Gross income for the first year was forecast as \$1,034,267 (compared to Mr Laurence's \$1,047,787). Profit for the first year was forecast as \$82,328 (compared to Mr Laurence's \$83,626). In other words, Mr Mirdjonov essentially adopted the gross income forecast which had been given to him by Mr Laurence.

498 The "Year 2" financial model was also amended in a number of ways, but the DD member numbers remained the same as had been contemplated in Mr Laurence's model.

499 Gross income for the second year was forecast as \$1,919,854 (compared to Mr Laurence's  
\$1,858,654). Total expenses for the second year were forecast as \$1,204,634.50 (compared to  
Mr Laurence's \$1,197,290.5) and profit was forecast as \$715,219.70 (compared to Mr  
Laurence's \$661,363.70).

500 Mr Mirdjonov's Business Plan sent on 7 July 2017 included:

**FINANCE PLAN**

**Capital Requirements and Funding Proposal**

\$1000000.00 start-up capital is required as per attached P/L Forecast sheet

Director will be financing the whole amount, pending complete business plan,  
location and agreed P/L forecast.

501 It is apparent from this that the "start-up capital" did not include Life Fitness equipment,  
because the "attached P/L Forecast" included Life Fitness equipment of \$345,000 in the  
"Year 1" tab as an operating expense at \$9,400 per month, and a total estimated set up cost  
of \$1,037,711.12 in the "Start Up Cost" tab which excluded equipment.

***10 July 2017: Email***

502 On 10 July 2017, Mr Mirdjonov sent an email to Mr Price, copied to Mr Laurence, attaching  
what he described as a "final draft of Business Plan and P/L forecast".

503 The "Start Up Cost" tab was not relevantly different to what had been sent by Mr Mirdjonov  
to Mr Laurence on 7 July 2017. The profit for the second year in the financial model remained  
at \$715,219.70. Member numbers had not changed in that, over the two year period, the model  
contemplated that 1,690 new members would have been obtained of which 1,587 were DD  
members.

***20 July 2017: Meeting with Mr Hagemrad and Email***

504 In his first affidavit, Mr Mirdjonov stated:

8 On 20 July 2017, I had a further meeting with Maz Hagemrad at the UFG Head  
Office at Wetherill Park. During the meeting Maz Hagemrad said that he had  
reviewed both the Business Plan and the Financial Model. He was focused  
more around the Financial Model. He went through all of the tabs on the  
spreadsheet including Start Up costs which were around \$1m and the two years  
of cash flow for the operations.

9 Maz said that he was happy with everything, including the cash flow forecasts  
and start up cost. The only thing he wanted me to change was the presales  
duration. Maz said I should reduce the presale period from 16 weeks to 8  
weeks.

505 In Mr Hagemrad's first affidavit, he stated:

51 I refer to paragraphs 8 and 9 of the Mirdjonov affidavit. I don't recall ever meeting with Laziz one on one. I have located a calendar entry for 20 July 2017 with Laziz, however I do not recall the meeting, or the details of what was discussed.

506 In his second affidavit, Mr Mirdjonov stated:

25 As to paragraph 51, I did have a meeting with Maz on 20 July 2017. This meeting [w]as to review the cash flow forecast and business plan. We discussed these in detail as set out in my previous affidavit in this proceeding.

507 I accept that a meeting occurred on 20 July 2017. I accept that Mr Hagemrad said he was happy with the cash flow forecasts and start-up costs. I note that Mr Mirdjonov's affidavit evidence does not establish that Mr Hagemrad confirmed that the start-up costs would be about \$1m. Rather, the affidavit in evidence is to the effect that Mr Hagemrad confirmed that the amounts stated on the "Start Up Cost" tab of the spreadsheet were correct: cf 2FASOC [47].

508 After the meeting with Mr Hagemrad, on 20 July 2017 at 1:53pm, Mr Mirdjonov emailed to Mr Price and Mr Hagemrad an updated "Business Plan" and "P/L forecast". The pre-sales period was reduced from 16 weeks to 8 weeks, consistently with Mr Mirdjonov's recollection of the meeting with Mr Hagemrad. The "Start Up Cost" tab was not relevantly different to what had been sent on 7 July 2017 and 10 July 2017. The profit for the second year in the financial model reduced to \$531,598.80. Member numbers changed a little. The model contemplated that, by the end of the two year period, 1,690 new members would have been obtained of which 1,542 were DD members. The model retained an average cancellation rate of 3% per month in the first year and 4% per month in the second year. In cross-examination, Mr Laurence agreed that the cancellation rate provided in this cash flow was less than what he had experienced at Wetherill Park: T450.2.

***After July 2017: Other discussions***

509 In his first affidavit, Mr Mirdjonov stated:

19 I had further telephone conversations with Maz and John Price. I do not know the exact dates of these telephone calls. The effect of these calls was that I was inquiring about the startup costs and Maz or John confirmed the costs would be in the range of \$1 million to \$1.2 million.

510 The word "further" indicates that, in his affidavit, Mr Mirdjonov was talking about meetings after 20 July 2017.

511 In Mr Hagemrad's first affidavit, he stated:

52 I refer to paragraph 19 of the Mirdjonov affidavit. I deny that I had any telephone conversations with Laziz. To the best of my knowledge, John may have had some telephone conversations with Laziz regarding set up costs.

512 In his second affidavit, Mr Mirdjonov stated:

26 As to paragraph 52, I had at least one telephone conversation with Maz, in which he said that out of pocket start-up expenses would be \$1 million to \$1.2 million.

513 In his affidavit, Mr Price stated:

10 I refer to paragraph 19 of the Mirdjonov affidavit. I do recall having some telephone calls with Laziz. During these calls I said words to the effect “the total cost to construct the gym will be somewhere between \$1 million to \$1.2 million excluding GST, plus there is the equipment you will need to lease. It would be impossible to give you exact costings until a site is finalised”.

514 In his second affidavit, Mr Mirdjonov stated:

10 As to paragraph 10 [of Mr Price’s affidavit], Mr Price did not say that the total out of pocket costs was excluding the costs of equipment or that the equipment would need to be leased. He did mention that there may be a finance option for the Life Fitness equipment. He did not say that the costs were exclusive of GST. He did not say that it would be “impossible to give you exact costings” or words to similar effect.

### ***23 August 2017: Disclosure document and franchise agreement***

515 On 23 August 2017, Mr Mirdjonov received from UFG a draft franchise agreement and disclosure document for a prospective franchisee.

516 The disclosure document was dated 27 April 2017. It was signed by Mr Hussein. It contained cl 14.3 to 14.5 in materially the same terms to the earlier disclosure documents.

517 Schedule 5 of the disclosure document commenced with same “boxed” warning as with the earlier disclosure documents.

518 In cross-examination, Mr Mirdjonov stated that he did not recall reading the “boxed” section in Schedule 5: T356.23. His evidence was that “anything [is] possible, but I’m pretty sure I didn’t read that”: T357.25.

519 Mr Mirdjonov, referring I assume to the franchise agreement, the disclosure document and the Code, observed that “it’s a massive document” and that he did not read the entirety of it, only reading those parts that were “more relevant”: T357.11. The franchise agreement, disclosure document and Code comprise approximately 264 pages. I accept that Mr Mirdjonov did not read the whole of each of the documents.



520 Table 1 of Schedule 5 of the disclosure document set out establishment costs totalling between \$820,500 to \$1,244,000 plus GST plus certain identified costs for which no specific amount was indicated. Table 1 provided:

**Table 1: Establishment Costs (Items 14.3, 14.4 and 14.5)**

Expenditures	Description of payment	Amount of the payment or the formula used to work out the payment	To whom the payment is made	When the payment is due	Whether refundable; if so, undue what circumstances
(a) Real property (including property type, location, and building size)	Leasing up front costs including your legal costs of reviewing lease and the like.	\$3,000 - \$5,000	Your solicitor and other third party suppliers	around the time of signing lease	Not refundable
	Costs of applying for development approval from the local council, if required	Will vary depending on site, Council and zoning	Your town planner	As required by town planner	Not refundable
(b) Equipment, fixtures, other fixed assets	Lease or purchase of equipment	\$350,000 - \$500,000	Franchisor, Various other suppliers	Prior to opening and upon purchasing.	Not refundable
(c) construction, remodelling, leasehold investments, decorating costs	Building, construction and fitout costs.	\$400,000 - \$650,000	Franchisor and Various contractors	Prior to opening during building stage.	Not refundable
(d) Inventory required to begin operation	Merchandise, Drinks and supplies	\$25,000	Franchisor	Prior to opening	Not refundable
(d) Security deposits, utility deposits, business licences, insurance and other prepaid expenses	Deposits for Electricity, Insurance etc	Varies based on supplier	Your preferred supplier	Prior to opening	Yes
(e) Additional funds (including working capital, required by the franchisee before	Required capital to maintain the business operations	\$40,000 - \$60,000	Third Parties	As incurred	Not refundable

operations begin)					
(f) Other payments by a franchisee to begin operations	Travel expenses for training, Pre-opening advertising	\$2,500 - \$4,000	Third parties	Prior to opening	Not refundable

521 In cross-examination, Mr Mirdjonov stated that he considered Table 1 to provide the range of start-up costs: T357.41. His evidence at T357.43 to T357. included:

You knew that they were not the actual start-up costs. That's the case, isn't it?---No, it's not. It's – it's the actual numbers that they've given on – based on their experience.

And you knew from what was stated in the boxed section that these numbers could vary. You knew that, didn't you?---I didn't. I just knew that there was a range. My calculation were based on the maximum ranges.

Mr Mirdjonov, at the time this document was provided to you, you had not identified the premises from which you were going to run the business. That's the case, isn't it?---Correct.

No timeframe had been worked out for when the building work would be carried out. That's the case, isn't it?---No.

You knew that the actual cost would depend on the size, condition and age of the premises. You knew that, didn't you?---I knew that. That's why I was looking at the ranges on the document.

And you knew that until the actual premises had been identified, all that you could be provided with was an estimate of the costs. That's the case, isn't it?---That's not true. They had already five clubs. I'm sure they knew what the maximum costs could be by then.

522 As with disclosure documents relevant to Balcatta and Blacktown, Table 2 included the initial franchise fee of \$60,000, plus GST and various other expenses and Table 3 included various expenses including legal fees payable to the franchisor's legal representatives.

523 An "Important Note" was set out at the end of Schedule 5, after the Tables. This was in similar or identical terms to the "important note" in the disclosure documents relevant to the Balcatta and Blacktown Franchises.

524 Mr Mirdjonov stated that he could not recall having read the "Important Note": T359. I think it unlikely that he read it.

525 As to the franchise agreement, Mr Mirdjonov did not read it in its entirety: T353.36. Clause 32.8 of the draft franchise agreement required the prospective franchisee to notify UFG of any representations in writing relating to the grant of the franchise. Mr Mirdjonov did not notify UFG of any such representations prior to signing the Castle Hill Franchise Agreement.

***15 September 2017: Franchisee certificate and execution of franchise agreement***

526 Mr Mirdjonov executed a “Franchisee Certificate” on 15 September 2017. He signed the Castle Hill Franchise Agreement in September 2017.

***Opening of Castle Hill UFC gym***

527 Mr Mirdjonov gave evidence that he achieved pre-sales in relation to the Castle Hill gym of between 1000 and 1100: T392. His evidence was that close to 40% “dropped off for whatever reason” when the gym opened. His evidence was that the gym was not breaking even when it opened and that it took 10 months until it broke even in around October or November of 2017.

***Financial information***

528 Significant time was spent in cross-examination about expenses which Mr Mirdjonov had claimed as company expenses which in truth were not. This expenditure included domestic travel, international travel, entertainment, restaurants, hotels, shopping in luxury stores and two Mercedes Benz motor vehicles. It is sufficient for present purposes to state that the expenses in the accounts of the company included personal expenditure in substantial amounts which should not have been claimed as company expenditure.

***Representations***

529 The third issue in the parties’ agreed list of issues was whether Mr Hagemrad and Mr Hussein made representations to Mr Mirdjonov to the effect that:

- (a) the franchisor had a proven business model that works in Australia: 2FASOC [41(a)];
- (b) the franchise breakeven point was approximately 600-700 members: 2FASOC [41(b)], [50];
- (c) the majority of members would be obtained during pre-sales of the gym so that once a gym was opened it would already likely to be at breakeven: 2FASOC [41(c)], [50];
- (d) as at 12 June 2017, existing UFC gyms that had opened in Australia were already very profitable: 2FASOC [41(d)];
- (e) franchisees for UFC gyms would be able to be established for start-up costs of approximately \$1,000,000 to \$1,200,000 depending on the site: 2FASOC [41(e)];
- (f) gross income for the Castle Hill gym would grow from \$79,825 on month one of opening \$120,736 by month 10: 2FASOC [43(a)], [47], [47A];

- (g) forecast total revenue for the first year would be \$1,212,579: 2FASOC [43(b)], [47], [47A];
- (h) membership would grow to 1272 members within 10 months of opening, growing between 69 and 150 new members monthly: 2FASOC [43(c)], [47A];
- (i) membership would continue to grow to 1690 members by the end of 22 months, generating income of \$1.83 million in the second year: 2FASOC [43(d)];
- (j) start-up costs would be flooring and fit-out costs of \$550,000, Life Fitness equipment costs of \$290,000, and Octagon and back rack costs of \$190,000: 2FASOC [44], [47];
- (k) establishment costs for the lease or purchase of equipment would be \$350,000 to \$500,000: 2FASOC [49(e)], [50];
- (l) establishment costs for building, construction and fit-out costs would be \$400,000 to \$650,000: 2FASOC [49(f)], [49(g)].

530 Each of these is a representation as to a future matter.

***Issue 3(a) – proven business model***

531 I am satisfied that Mr Hagemrad represented that the franchisor had a proven business model that works in Australia.

***Issue 3(b) – breakeven point***

532 I conclude that Mr Hagemrad represented that the franchise breakeven point was approximately 600 to 700 members. I preferred Mr Mirdjonov’s evidence on this topic to the evidence of Mr Hagemrad and Mr Price. I note that Mr Laurence’s revised cash flow which he had sent to Mr Kim on 10 October 2016 in relation to the Blacktown Franchise contemplated profitability at around this level. The number is not inconsistent with the financial models sent to Mr Mirdjonov on 13 June 2017 and 2 July 2017. In reaching this conclusion, I recognise that both of those models contemplated rent free periods.

533 Mr Mirdjonov’s financial models were made by him by amending the model sent to him on 2 July 2017. His models, sent on 7 July 2017 and 10 July 2017 (which both included rent free periods), contemplated profitability between 550 and 660 members.

534 Mr Mirdjonov’s financial model sent on 20 July 2017 (which also included rent free periods) contemplated profitability between 560 and 677 members.

***Issue 3(c) – members from pre-sales***

535 I do not accept that Mr Hagemrad represented that the majority of members were likely to be obtained during pre-sales such that, once a gym was opened, it would already likely be at breakeven point. Mr Mirdjonov’s recollection of what was said is likely to have been affected by the passage of time and later events. It was uncontroversial that pre-sales were discussed. I think it more likely that the discussion concerned the desirability of obtaining as many members as possible during pre-sales so that the breakeven point could be reached as soon as possible.

***Issue 3(d) – profitability of existing UFC gyms***

536 I accept that Mr Hagemrad represented on 12 June 2017 that the existing UFC gyms that had opened in Australia were profitable. Again, I prefer Mr Mirdjonov’s evidence on this topic. The financial model based on “learnings” from Wetherill Park indicated profitability. No contemporaneous communication between UFG and Mr Mirdjonov suggested any of the existing UFC gyms in Australia were experiencing difficulties or were not profitable.

***Issue 3(e) – start-up costs of \$1 to \$1.2 million***

537 I accept that, at the meeting on 12 June 2017, Mr Price (and UFG) represented that franchises for UFC gyms would be able to be established for start-up costs of approximately \$1,000,000 to \$1,200,000 depending on the site. On balance, it is unlikely that Mr Price qualified the statement in the way he suggested in his evidence.

538 I note that, on 2 July 2017, Mr Laurence sent an email to Mr Mirdjonov attaching the “Wetherill Park BP and Forecast Template”. The attached financial model included, as the first tab, the “Start Up Cost”. The “estimated set up costs” plus all equipment totalled  $\$804,311.12 + \$195,000 + \$290,000 = \$1,289,311.12$ . If one excludes the Life Fitness equipment, the total was  $\$999,311.12$ . It was not suggested by the respondents that the equipment at the bottom left of the “Start Up Cost” tab was relevant.

539 As will be discussed later, by 7 July 2017 at the latest, but probably earlier, Mr Mirdjonov knew that the models he had been provided, and that he amended, proposed “leasing” the Life Fitness equipment at a cost of \$345,000 rather than purchasing it outright at commencement. This was clearly provided for on the “Year 1” and “Year 2” tabs of the excel spreadsheet.

***Issue 3(f) and (g) – gross income***

540 I accept that Mr Hagemrad (and UFG) represented that it was likely that gross income for the Castle Hill gym would grow from \$79,825 on month 1 of opening to \$120,736 by month 10, being amounts shown in the “Year 1” tab of Mr Mirdjonov’s 20 July 2017 model. These amounts were based on month 1 DD members of 450 and month 10 DD members of 1,272.

541 The model sent by Mr Laurence on 2 July 2017 had forecast month 1 income at \$90,475, based on 550 DD members. It forecast month 10 income at \$130,672 based on 1,344 DD members. Mr Mirdjonov’s 7 and 10 July 2017 models forecast month 1 income at \$87,475, based on 550 DD members and month 10 income at \$129,592 based on 1,344 DD members.

542 On 2 July 2017, UFG put forward a model said to be related to Wetherill Park. In context, the 2 July 2017 email represented that the attached financial model reflected what was being and what was considered likely to be achieved at Wetherill Park and what could be achieved by Mr Mirdjonov. At no point did any person state that the model was in any way inaccurate. Mr Hagemrad discussed with Mr Mirdjonov and accepted and endorsed Mr Mirdjonov’s 20 July 2017 amendments to that model. In context, in doing so, Mr Hagemrad represented that the Castle Hill Franchise would be likely to generate income in the order shown in the 2 July 2017 financial model and in the 20 July 2017 financial model which was based on the 2 July 2017 financial model.

543 For the same reasons, I also accept that Mr Hagemrad (and UFG) represented that it was likely that forecast total revenue for the first year would be \$935,588 and that it would be \$1,212,579 12 months after opening.

***Issue 3(h) – membership growth in Year 1***

544 For the reasons given in relation to Issue 3(f) and (g), I also accept that Mr Hagemrad (and UFG) represented that it was likely that membership would grow to 1272 members within 10 months of opening, growing by between 71 and 150 new members monthly, taking into account cancellations.

***Issue 3(i) – membership growth and income by the end of Year 2***

545 I accept that Mr Hagemrad (and UFG) represented that membership was likely to continue to grow to about 1690 members by the end of 22 months: 2FASOC [47A(d)].

546 I am also satisfied that Mr Hagemrad (and UFG) represented that income of \$1.83 million  
would be generated in the second year: 2FASOC [47A(d)].

547 The reasons for concluding that these representations were conveyed by Mr Hagemrad's (and  
UFG's) conduct are the same as have been given in relation to Issue 3(f) and (g)

***Issue 3(j) – start-up costs***

548 The 2FASOC included:

44 The estimate of startup costs was in the form of an Excel worksheet titled,  
“Estimated Set Up Costs + GST” within the same workbook referred to above,  
which estimated that startup costs would be:

- (a) flooring and fit-out costs of \$550,000;
- (b) life fitness equipment cost of \$290,000;
- (c) Octagon and back rack costs of \$190,000.

...

47 During this meeting, Maz Hagemrad reviewed the worksheets with Laziz  
Mirdjonov and made oral representations to the effect:

- (a) he confirmed that startup costs would be only about \$1 million;
- (b) he confirmed that the income projections were correct.

549 I am not satisfied that, on 20 July 2017, Mr Hagemrad represented that start-up costs would be  
about \$1 million or \$1,030,000, comprising: flooring and fit-out costs of \$550,000; Life Fitness  
equipment costs of \$290,000; and Octagon and back rack costs of \$195,000.

550 At the meeting on 20 July 2017, in endorsing the “Start Up Cost” tab of the 20 July 2017  
financial model, Mr Hagemrad represented that, apart from the cost of Life Fitness equipment,  
it was likely that the costs in the “Start Up Cost” tab would be incurred up front. These included  
the various items in the: “estimated set up costs” table totalling \$1,037,711.12; the Octagon  
and back rack equipment costs of \$195,000; and other identified equipment totalling  
\$51,713.31 (presumably excluding GST) = \$1,284,424.43. The “estimated set up costs” of  
\$1,037,711.12 included fit-out costs of \$550,000 and working capital of \$200,000.

551 Mr Hagemrad (and UFG) did not represent, on 20 July 2017, that the Life Fitness equipment  
cost of \$290,000 would be incurred up front. Rather, he represented that the Life Fitness  
equipment was likely to be paid for monthly as an operational expense and that it would be  
\$345,000. Although tab 1 of the 20 July 2017 financial model referred to \$290,000 for the Life  
Fitness equipment, the “Year 1” and “Year 2” tabs recorded the Life Fitness equipment as

costing \$345,000, paid for by way of monthly repayments of \$9,400. Tab 1 also indicated that the Life Fitness equipment could be “financed[,] [s]ecured against assets or paid outright” and provided two different calculations for monthly repayment options.

***Issue 3(k) – establishment costs for lease or purchase of equipment***

552 I accept that, by paragraph (b) of Table 1 in Schedule 5 to the disclosure document, Mr Hussein, Mr Hagemrad and UFG represented that the cost for the “lease or purchase of equipment” was likely to be between \$350,000 to \$500,000.

***Issue 3(l) – establishment costs for fit-out***

553 I accept that, by paragraph (c) of Table 1 in Schedule 5 to the disclosure document, Mr Hussein, Mr Hagemrad and UFG represented that the amount for “building, construction and fit-out costs” was likely to be between \$400,000 to \$650,000.

**Reliance**

554 The representations which were conveyed can be grouped into two broad groups:

- income, membership and performance representations: Issue 3(a), (b), (d), (f) to (i);
- establishment costs representations: Issue 3(e), (k) and (l).

555 As with the others individuals, the question whether Mr Mirdjonov relied on the representations in entering into the franchise agreement and guarantee turns on all of the facts assessed in context, including his experience, the documents he read before entering into the franchise agreement – which included the disclosure document, the franchise agreement and the franchise certificate – and the advice he received. I have taken these matters into account in assessing reliance.

***Income, membership and performance representations: Issue 3(a), (b), (d), (f) to (i)***

556 It was put to Mr Mirdjonov in cross-examination that he drew on his experience in preparing the 20 July 2017 financial model. His evidence in cross-examination at T350 included:

You understood, Mr Mirdjonov, that, for you to become a UFC franchisee in Australia, approval had to be sought from the US. You understood that on 20 July 2017?---I’m not sure about the date but I understood there was two levels of approval. One is by UFC Australia, specifically by Maz, and then the second level was to send it to US.

And what you wanted from Mr Hagemrad was confirmation that you had prepared your documents in a form that the – that UFC in the US was looking for. That’s the case, isn’t it?---No. He was actually reviewing if the model was actually realistic.



You – what you did, Mr Mirdjonov, is, in preparing these spreadsheets, you drew on your experience in business and you projected how this business would perform with – if you started up and you were involved in its running. That’s the case, isn’t it?---It was based on the numbers that they provided to me. Based on that meeting, Mr Hagemrad reviewed the spreadsheet. He was happy with all the numbers because, essentially, all the – most of them were from – taken from existing gym. And he asked me to remove pre-sale because he said that, in his experience, it’s ineffective.

And, following that meeting, you made changes to these documents that you considered to be appropriate. That’s the case, isn’t it?---Based on his feedback.

Mr Hagemrad did not say to you that he was happy with the cash flow figures. That’s the case, isn’t it?---Mr Hagemrad was very happy with the figures.

He did not say that to you, Mr Mirdjonov. That’s the case, isn’t it?---He did say it to me. No. He did say it to me.

557 Mr Mirdjonov’s reference to “remove pre-sales” is a reference to removing 2 of the 4 months of pre-sales, being one change which Mr Mirdjonov had made. Mr Laurence had proposed 2 months of pre-sales in his financial model and Mr Mirdjonov had spread that over 4 months. His cross-examination at T351 included:

Mr Mirdjonov, you know a forecast is not a prediction of something which will happen. That’s the case, isn’t it?---Yes.

When you sent this document to UFC on 20 July 2017, you knew there was no guarantee that what was shown in these documents would actually be achieved. You knew that, didn’t you?---Well, I mean, based on what they told me, based on proven business model and the performance of previous clubs, my assumption was that the club would perform at worse at these numbers.

558 I accept Mr Mirdjonov’s evidence set out above.

559 On several occasions it was put to Mr Hagemrad that he had read the following disclaimer which appeared on the first to third tabs of each financial model – “Start Up Cost”, “Year 1” and “Year 2” – at the bottom of each page:

This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however highlights the opportunity.

560 I think it more likely than not that Mr Mirdjonov did read the disclaimer at the time he worked on the financial model to make his amendments. His evidence at T351 included:

And are you seriously saying that at no stage, with these emails going between you and UFC, are you seriously saying that you never read those words?---Look, from memory, that wasn’t my focus. I don’t remember really seeing them. As I said, my focus was primarily around numbers. And, I mean, we had so many meetings with Maz and Jason. We were working as a working model of the future gym based on the proven business model of UFC GYM.

Do you accept that it was possible that you saw those words?---It could be .....

561 Mr Mirdjonov's evidence in cross-examination at T341 included:

And you saw that – you saw the words, “under the table” – I withdraw that. You saw the words at the bottom of this document that said the following:

*This model is a forecast only and not a representation capable of reliance or guarantee of outcomes, however, highlights the opportunity.*

You saw those words?---Maybe. I don't recall.

You give evidence, Mr Mirdjonov, that you relied on cash flows provided to you by UFG, correct?---The way we were talking with Jason, it was about the real club and the real money. So my reliance on it was yes, hundred per cent.

...

If you read those words, Mr Mirdjonov, you would have known that what was indicated in this document was a forecast, correct?---It was forecast based on existing model – based on existing gym. So it was realistic numbers. The way we were speaking with Jason, it was presented to me that these are the real numbers.

562 I accept that Mr Mirdjonov's evidence set out above relied on the context of the financial model provided to him by Mr Laurence which he, Mr Mirdjonov, considered reflected the reality of the situation at Wetherill Park.

563 It was put to Mr Mirdjonov that the reason he did not notify UFG that he was relying on any representations, as required by cl 32.8 of the franchise agreement, was because he was not relying on any cash flow or revenue representations. He denied this. His evidence at T354-5 included:

You say that in signing the franchise agreement, you relied on cash flow or revenue representations which had been made by UFG, correct?---Correct.

Prior to signing the franchise agreement, you did not notify UFG that you were relying on such representations, correct?---Well, I mean, it was obvious. I mean, we worked on it. They understood it clearly, but I didn't notify them specifically about it.

And the reason you didn't do that, Mr Mirdjonov, is by the time you signed the franchise agreement, you were not relying on any cash flow or revenue representations made by UFG. That's the case, isn't it?---No, it's not. I was relying on the cash flow 100 per cent.

You had made your own calculations as to how you thought you could run a UFG business and what revenue you could achieve from it, and that is what you were relying on. That's the case, isn't it?---No, that's not true.

564 I accept this evidence.

565 I am satisfied that, in agreeing to enter into the franchise agreement and in guaranteeing the obligation of the franchisee, Mr Mirdjonov relied on each of what I have referred to as the income, membership and performance representations that were conveyed. Mr Mirdjonov's

20 July 2017 financial model was based on what he had been provided to him by Mr Laurence on 2 July 2017. Mr Laurence’s email of 2 July 2017 referred to the “attached Wetherill Park BP and Forecast Template”. I accept that Mr Mirdjonov relied on the financial model which had been provided to him on the basis that he considered, from the interactions between him and Mr Laurence, that the financial model Mr Laurence had provided reflected the reality of what had been experienced at Wetherill Park up until the point in time it was provided to Mr Mirdjonov and a reliable forecast to the extent it related to the future.

566 Mr Mirdjonov applied his mind to various aspects of the model, but essentially relied on what had been given to him on 2 July 2017: Issues 3(f) to (i). Of particular significance were the member numbers, cancellations and growth recorded in Mr Laurence’s financial model of 2 July 2017, which Mr Mirdjonov would justifiably have understood as being based on experience with Wetherill Park.

567 In the financial model sent on 7 July 2017, Mr Mirdjonov adopted the membership numbers and cancellations which had been provided to him. By the time of his final cash flow, sent on 20 July 2017, the numbers were slightly lower. This was not done as a result of anything which Mr Hagemrad or Mr Laurence suggested.

568 In assessing the financial model which had been given to him on 2 July 2017, and in preparing the 20 July 2017 model, and in deciding to enter into the franchise agreement and guarantee, I conclude that Mr Mirdjonov also drew comfort from being told that: UFG had a proven business model which worked in Australia: Issue 3(a); the breakeven point was between 600 and 700 members: Issue 3(b); and the existing UFC franchises were operating profitably: Issue 3(d).

***Establishment costs representations: Issue 3(e), (k) and (l)***

569 As to Issue 3(e), I consider that Mr Mirdjonov would only have relied to a minor degree on what Mr Price had said at the 12 June 2017 meeting. He would have relied more heavily on the more detailed explanation of costs in the 20 July 2017 financial model. What Mr Price had said at the 12 June 2017 meeting would have given Mr Mirdjonov comfort in his view that the ranges in the 2 July 2017 and 20 July 2017 models would not be exceeded to any significant degree and in assessing the risk that the maximum in the range might be exceeded.

570 As to Issue 3(k), I do not accept that Mr Mirdjonov would have relied on paragraph (b) of Table 1 in Schedule 5 to the disclosure document, that the cost for the “lease or purchase of

equipment” was likely to be between \$350,000 to \$500,000, which would have been understood as being exclusive of GST. This is unlikely because, at the point in time when he read the disclosure document, he knew from the 20 July 2017 financial model that the estimated cost of equipment, exclusive of GST, included at least an amount exceeding \$500,000, exclusive of GST: \$195,000 for “Equipment (Octagon and Bag Rack); \$345,000 for “Life Fitness Equipment”; and other identified equipment totalling \$51,713.31. The identified equipment totalling \$51,713.31 referred to on tab 1 of the financial model at the bottom left of the page was not addressed by any evidence or submissions (although referred to by the Court) and was left unexplained. In any event, Mr Mirdjonov would have relied on the detailed financial model in relation to the cost of equipment rather than the disclosure document.

571 As to Issue 3(l), I accept that Mr Mirdjonov relied on paragraph (c) of Table 1 in Schedule 5 to the disclosure document that the establishment costs for building, construction and fit-out costs were likely to be between \$400,000 to \$650,000, exclusive of GST. This was consistent with the reference to \$550,000 for “Flooring and Fit out Cost” and \$50,000 for “Internal + External Signs” contained in the 2 July 2017 and 20 July 2017 financial models.

#### **Misleading conduct: Issues 5 to 7**

572 As noted earlier, Issues 5 to 7 were:

- (5) To the extent any representations were with respect to future matters, whether the respondents have adduced “evidence to the contrary” within the meaning of s 4(2) of the ACL.
- (6) To the extent any representations were with respect to a future matter, whether the respondents had reasonable grounds to make the representations.
- (7) Whether the respondents engaged misleading or deceptive conduct, in contravention of s 18 of the ACL in respect of any:
  - (a) representations with respect to a future matter; and
  - (b) the balance of any representations made.

573 These issues can be addressed together.

574 In summary, I have found that Mr Mirdjonov relied on the following representations:

- (a) income, membership and performance representations:
  - Issue 3(a): UFG had a proven business model that worked in Australia;
  - Issue 3(b): the breakeven point was approximately 600 to 700 members;
  - Issue 3(d): the existing UFC gyms that had opened in Australia were profitable;

- Issue 3(f) and (g): it was likely that gross income for the Castle Hill gym would grow from \$79,825 on month one of opening \$120,736 by month 10 and that forecast total revenue for the first year would be \$935,588 and that it would be \$1,212,579 12 months after opening;
- Issue 3(h): it was likely that membership would grow to 1272 members within 10 months of opening, growing between 71 and 150 new members monthly, taking into account cancellations;
- Issue 3(i): by the end of the two year period, 1,690 new members would have been obtained and that it was likely that income of about \$1,832,217 would be generated in the second year.

(b) establishment costs representations: Issue 3(e) and (l):

- Issue 3(e): the establishment costs would likely be in the range \$1 to \$1.2 million;
- Issue 3(l): the establishment costs for building, construction and fit-out costs were likely to be between \$400,000 to \$650,000.

### ***Income, membership and performance representations***

#### *Proven business model that worked in Australia*

575 The representation that UFG had a proven business model that worked in Australia was a representation of existing fact. It was misleading in that some of the UFC Gym franchises were not performing well.

#### *Breakeven point was approximately 600 to 700 members*

576 The representation that the breakeven point was approximately 600 to 700 members was a representation of existing fact and would also have been understood as a representation as to what one could expect in the Castle Hill Franchise, being a representation as to a future matter.

577 The evidence did not establish in relation to any franchise that the franchise had a breakeven point of 600 to 700 members. That fact, if it were true, would have been relatively easy to establish, particularly in relation to the Wetherill Park gym.

578 To the extent that the representation was one as to a future matter, “evidence to the contrary” was not adduced and I would, in any event, have concluded that there were not reasonable grounds to make it.

579 The representation was misleading.

*The existing UFC gyms that had opened in Australia were profitable*

580 The representation that the existing UFC gyms that had opened in Australia were profitable was one of existing fact. It was misleading and deceptive because both the Balcatta Franchise and Blacktown Franchise were not profitable at the time.

*The gross income and membership number representations*

581 As noted earlier, what was represented to Mr Mirdjonov by the 2 July 2017 email included that it was reasonably likely that the Castle Hill Franchise would enjoy membership growth and income according to the financial model attached to the email which was stated to be related to Wetherill Park. This was a representation as to a future matter.

582 It was submitted that there were reasonable grounds for making the representations because the financial model given to Mr Mirdjonov was “based on the performance of the existing [Wetherill Park] UFC Gym”: T689.30. However, Mr Laurence’s evidence was that the spreadsheet was created by him “with input from” Mr Hagemrad “based on learnings from UFC Wetherill Park and my overall experience”. Mr Laurence did not explain how any of the figures were derived beyond those assertions. The respondents could have established the actual performance which had been experienced at Wetherill Park. They did not. There was no explanation as to whether and how the membership growth and cancellations contained in the model departed from the actual experience at Wetherill Park and why, if it did, a departure from actual experience was considered appropriate. Mr Laurence’s evidence suggests that there were departures.

583 There was no attempt to explain how membership growth or contemplated cancellations were regarded as reasonable, beyond the bare assertion that it was based on Mr Laurence’s experience. There was no attempt to explain why total membership of about 1,690 at the end of two years was regarded as reasonable, beyond the bare assertion that it was based on Mr Laurence’s experience.

584 The evidence adduced was insufficient to constitute “evidence to the contrary”. In particular, it was not possible to determine from the evidence given whether Mr Laurence or Mr Hagemrad considered the membership growth to 1690 members to be reasonable or what had actually been taken into account in taking that view. It follows that Mr Hagemrad and UFG are “taken

not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1).

585 In any event, I would have held that the Castle Hill applicants had established that there were not reasonable grounds for making the income representations. The respondents did not have reasonable grounds to assume the member numbers which they did.

586 It was submitted that the representations made by the 2 July 2017 email were, or included, representations as to the then existing performance of the Wetherill Park UFC Gym and that it was for the applicants to prove that a representation of existing fact was misleading or deceptive. This submission could only theoretically apply to part of the 2 July 2017 financial model, given the Wetherill Park UFC Gym had not operated for two years by the time that model was prepared and given to Mr Mirdjonov.

587 The submission is in any event rejected for two reasons. *First*, even if the representation included a representation as to an existing matter, it was also a representation with respect to a future matter, namely that which could be expected at Castle Hill.

588 *Secondly*, in any event, the evidence did not establish that the 2 July 2017 financial model did reflect the actual performance of Wetherill Park for the months that it had operated at the time the model was prepared. To the extent the financial model included representations as to existing fact about the cash flows and member numbers at Wetherill Park up until the time it was prepared, I conclude that it was misleading or deceptive. I take from Mr Laurence’s evidence that the financial model was prepared with input from Mr Hagemrad, “learnings” from Wetherill Park and Mr Laurence’s experience, that it did not reflect the actual performance at Wetherill Park. The evidence as a whole must be assessed according to the capacity of the party to have adduced evidence on the topic. No attempt was made by the respondents to establish that the 2 July 2017 financial model adopted in part the then existing performance at the Wetherill Park UFC Gym.

### ***Establishment costs representations***

589 As to Issue 3(e), the representation that total establishment costs would be between \$1 and \$1.2 million would only have been relied upon to a minor degree, namely by informing the assessment of risk that the costs in the 20 July 2017 financial model would be exceeded and, if so, by how much. There were not reasonable grounds for making the representation when it was made, but the causal contribution of the representation is minor.

590 As to Issue 3(1), I have accepted that, in the Castle Hill Disclosure Document, the establishment costs for “building, construction and fit-out costs” were represented as likely to be between \$400,000 to \$650,000.

591 The respondents relied on the same quotations and invoices as they relied on in relation to the Second Disclosure Document and the Blacktown disclosure document as “evidence to the contrary” and for the proposition that there were reasonable grounds for making the representations concerning total fit-out costs.

592 For the reasons given earlier, I am not satisfied that the evidence adduced constituted “evidence to the contrary”. It follows that Mr Hagemrad and UFG are “taken not to have had reasonable grounds for making the representation” (s 4(2)) and that “the representation is taken ... to be misleading”: s 4(1).

593 In any event, I would have held that the Castle Hill applicants had established that there were not reasonable grounds for making the representation concerning fit-out. In this assessment, I have taken into account the actual costs of fit-out and sought to take account of hindsight bias.

### ***The conduct***

594 I am satisfied, after considering the representations made in the context of the whole course of events, that Mr Hagemrad and Mr Hussein, and through them UFG, engaged in misleading conduct in contravention of s 18 of the ACL.

### **LOSS AND DAMAGE AND RELIEF**

595 The eighth to thirteenth issues were identified in the following way:

- (8) what is the quantum of loss and damage, if any, suffered by each of:
  - (a) the Balcatta Franchisee;
  - (b) the Blacktown Franchisee;
  - (c) the Castle Hill Franchisee.
- (9) whether any loss for each Franchisee is appropriately measured by reference to, and the quantum of:
  - (a) the capital outlays to commence the business;
  - (b) the borrowing cost to fund the outlays and operating costs;
  - (c) the operating losses from the commencement of the business;
  - (d) the residual value of the businesses including the value of tangible assets and any commercial goodwill.



- (10) whether any loss referable to the capital outlays to commence the franchise businesses should be off-set against the value of the businesses as at the date of acquisition of the businesses or the current residual value of the businesses;
- (11) whether and to what extent COVID-19 was a supervening or extraneous event;
- (12) whether and to what extent the Referee's findings should be adopted;
- (13) any relief appropriate pursuant to s 237 of the ACL, including compensation and declaring the Franchise Agreements and the personal guarantees void.

### **The referee report**

596 Orders were made by consent on 27 October 2022 under s 37P(2) and s 54A of the *Federal Court of Australia Act 1976* (Cth) referring certain identified questions relating to losses and damage to a referee to make a report to the Court. This referral resulted in two reports, dated 24 March 2023 and 31 March 2023. One objective behind the referral was to reduce costs and delay by avoiding what were then perceived to be escalating difficulties in relation to experts on both sides. The referral was considered likely to result in reduced costs and delay overall and a shorter hearing.

597 The applicants ran their case on the basis that, if the misleading or deceptive conduct had not occurred, they would not have executed the franchise agreements or guarantees such that those should each be set aside and that their losses were:

- (a) the sum of:
  - (i) the costs they each incurred in setting up the franchises;
  - (ii) the borrowing costs each incurred; and
  - (iii) the net operating losses incurred in running the franchises;
- (b) less the residual value of the businesses.

598 In summary, the referee was to report on:

- (a) the start-up costs of each franchise;
- (b) the borrowing costs for each franchise;
- (c) the operating profit or loss for each franchise up to 31 December 2022;
- (d) whether there was any "commercial goodwill" in any of the franchises as at 31 December 2022;
- (e) whether the operating profits or losses for any of the franchises was affected by Commonwealth or State responses to the pandemic;

- (f) the value of the franchise businesses as at:
  - (i) the date of entry into the relevant franchise agreement; and
  - (ii) a date proximate to the referee's report;
- (g) whether the value of any of the businesses was affected by Commonwealth or State responses to the pandemic.

599 The referee valued the businesses as at (i) the date of entry into the relevant franchise agreement and (ii) 31 December 2022. After determining that each of the businesses had sustained significant trading losses whilst being operated and that none had any commercial goodwill, the referee determined the value of the businesses as at 31 December 2022 by reference to the liquidation value of the assets, less liabilities.

600 The referee reached the following conclusions of central relevance.

601 As to the Balcatta Franchise:

Start-up costs:	\$1,399,184
Net operating losses:	\$ 423,045
Borrowing costs:	<u>\$ 97,067</u>
Sub-total	\$1,919,296
Value as at 31.12.22	<u>\$ 174,480</u>
Total	\$1,744,816

602 As to the Blacktown Franchise:

Start-up costs:	\$1,394,205
Net operating losses:	\$ 391,076
Borrowing costs:	<u>\$ 148,453</u>
Sub-total	\$1,933,734
Value as at 31.12.22	<u>\$ 26,951</u>
Total	\$1,906,783

603 As to the Castle Hill Franchise:

Start-up costs:	\$1,448,264
Net operating losses:	\$ 962,304
Borrowing costs:	<u>\$ 62,897</u>
Sub-total	\$2,473,465
Value as at 31.12.22	<u>\$ 121,399</u>
Total	\$2,352,066

604 The principles concerning adoption – expressed by reference to the Rules of Court then applicable in the Supreme Court of New South Wales – were summarised by McDougall J in *Chocolate Factory Apartments Ltd v Westpoint Finance Pty Ltd* [2005] NSWSC 784 at [7]:

- (1) An application [for adoption of a referee's report] under Pt 72 r 13 is not an appeal either by way of hearing de novo or by way of rehearing.
- (2) The discretion to adopt, vary or reject the report is to be exercised in a manner consistent with both the object and purpose of the rules and the wider setting in which they take their place. Subject to this, and to what is said in the next two sub paragraphs, it is undesirable to attempt closely to confine the manner in which the discretion is to be exercised.
- (3) The purpose of Pt 72 is to provide, where the interests of justice so require, a form of partial resolution of disputes alternative to orthodox litigation, that purpose would be frustrated if the reference were to be treated as some kind of warm up for the real contest.
- (4) In so far as the subject matter of dissatisfaction with a report is a question of law, or the application of legal standards to established facts, a proper exercise of discretion requires the judge to consider and determine that matter afresh.
- (5) Where a report shows a thorough, analytical and scientific approach to the assessment of the subject matter of the reference, the Court would have a disposition towards acceptance of the report, for to do otherwise would be to negate both the purpose and the facility of referring complex technical issues to independent experts for enquiry and report.
- (6) If the referee's report reveals some error of principle, absence or excessive jurisdiction, patent misapprehension of the evidence or perversity or manifest unreasonableness in fact finding, that would ordinarily be a reason for rejection. In this context, patent misapprehension of the evidence refers to a lack of understanding of the evidence as distinct from the according to particular aspects of it different weight; and perversity or manifest unreasonableness mean a conclusion that no reasonable tribunal of fact could have reached. The test denoted by these phrases is more stringent than "unsafe and unsatisfactory".
- (7) Generally, the referee's findings of fact should not be re-agitated in the Court. The Court will not reconsider disputed questions of fact where there is factual material sufficient to entitle the referee to reach the conclusions he or she did, particularly where the disputed questions are in a technical area in which the referee enjoys an appropriate expertise. Thus, the Court will not ordinarily interfere with findings of fact by a referee where the referee has based his or her findings upon a choice between conflicting evidence.
- (8) The purpose of Pt 72 would be frustrated if the Court were required to reconsider disputed questions of fact in circumstances where it is conceded that there was material on which the conclusions could be based.
- (9) The Court is entitled to consider the futility and cost of re-litigating an issue determined by the referee where the parties have had ample opportunity to place before the referee such evidence and submissions as they desire.
- (10) Even if it were shown that the Court might have reached a different conclusion in some respect from that of the referee, it would not be (in the absence of any of the matters referred to in sub para (6) above) a proper exercise of the discretion conferred by Pt 72 r 13 to allow matters agitated before the referee to be re-explored so as to lead to qualification or rejection of the report.
- (11) Referees should give reasons for their opinion so as to enable the parties, the Court and the disinterested observer to know that the conclusion is not

arbitrary, or influenced by improper considerations; but that it is the result of a process of logic and the application of a considered mind to the factual circumstances proved. The reasoning process must be sufficiently disclosed so that the Court can be satisfied that the conclusions are based upon such an intellectual exercise.

- (12) The right to be heard does not involve the right to be heard twice.
- (13) A question as to whether there was evidence on which the referee, without manifest unreasonableness, could have come to the decision to which he or she did come is not raised “by a mere suggestion of factual error such that, if it were made by a trial judge, an appeal judge would correct it”. The real question is far more limited: “to the situation where it is seriously and reasonably contended that the referee has reached a decision which no reasonable tribunal of fact could have reached; that is, a decision that any reasonable referee would have known was against the evidence and weight of evidence”.
- (14) Where, although the referee’s reasons on their face appear adequate, the party challenging the report contends that they are not adequate because there was very significant evidence against the referee’s findings with which the referee did not at all deal, examination of the evidence may be undertaken to show that the reasons were in fact inadequate because they omitted any reference to significant evidence.
- (15) Where the court decides that the reasons are flawed, either on their face or because they have been shown not to deal with important matters, the court has a choice. It may decline to adopt the report. Or it may itself look at the detail of the evidence to decide whether or not the expense of further proceedings before the referee (which would be the consequence of non adoption) is justified.

605 For the reasons which follow, the Court will adopt parts of the referee’s report.

### **The value of the franchise businesses on entry into the franchise agreements**

606 The referee assessed the value of the franchisees’ businesses as at the date of entry into the franchise agreements by reference to actual capital and other expenditure up until the opening of the gyms. The referee did this because cash flow or earnings based valuation methodologies were considered to be unreliable, there being no existing business to provide the necessary data. Using the Balcatta Franchise as an example, the referee stated in his 1<sup>st</sup> report:

- 125 ... I have no reliable information on which to consider the value of the Applicant Franchise business based on cash flow or earnings based approaches.
- 126 As a result, I consider it necessary to apply an asset based approach. In applying that approach I have considered the adjusted book value methodology. This methodology relies on adjusting the amounts stated in the financial accounts to their estimated market value.
- 127 The difficulty in applying such an approach is that the primary assets of the business following commencement are the fit- out of the business premises and the plant & equipment used in the business. However, those assets do not yet exist at the date at which the franchise agreement was entered into.

128 My underlying assumptions are that:

- a The amount spent was the amount needed to be spent to satisfy the obligations of the franchisee under the franchise agreement;
- b These funds were spent on the expectation that the business would be sufficiently successful to make the investment reasonable; and
- c The amount spent is therefore a proxy for the expected value of the business.

129 No market valuation exists for those assets on commencement and the only information held is the original cost of those assets. As a result I have relied on the original start-up cost in my assessment of the value of the business at the date the agreement was entered into.

130 In the absence of any other valuation information concerning these assets I consider there is no basis for adjusting asset amounts to any value other than the amount originally spent.

607 According to the respondents, it followed from these conclusions that the applicants had suffered no loss because the value of what they acquired by their expenditure was equal to the value of the business on opening.

608 The respondents submitted that, in a “no transaction” case, the appropriate measure of damages is ordinarily the difference between the price an applicant paid for what was received and the value of what was received as at the date of acquisition: *Kizbeau Pty Ltd v WG & B Pty Ltd* [1995] HCA 4; 184 CLR 281 at 291.

609 As is discussed further below, the true principle for the purposes of s 236 of the ACL is that an applicant should be compensated for the losses which have been sustained “because of” the misleading conduct. This often raises subsidiary valuation issues. Losses are often appropriately determined by reference to the difference between the purchase price and the true value of the asset at the date of acquisition, particularly where what was acquired is readily realisable, there is no continuing inducement because of the misleading conduct and there is no other issue requiring special consideration such as where the applicant is locked into the business acquired – see, for example: *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* [2004] HCA 54; 217 CLR 640 at [66].

610 Here, the applicants expended money on setting up businesses which did not and were unlikely ever to generate a profit. The businesses had no value as a going concern; this was not a case of businesses turning a profit which was not as much as expected. The application of s 236 of the ACL according to its terms and the application of the general principle to which the respondents referred lead to the same result. The applicants incurred expenditure on setting up

near valueless businesses. The “price paid” is the sum of the establishment costs; the value of what was received was not that which was expended. As is discussed further below, in the circumstances of this case, the applicants must give credit for the residual value of the businesses which has been determined as at 31 December 2022.

611 It is illogical to conclude that the value of a business which is unlikely ever to generate a profit is the amount expended to set it up. If anything, the value of such a business, at the time each business was opened, was the value of the assets of the business on a forced liquidation, less liabilities. The referee’s reasoning, particularly at [128] of the 1<sup>st</sup> Report set out above, is really saying no more than that the applicants *expected* that the value of the businesses would be at least (but probably more than) what they were expending on setting up the business, otherwise they would not incur the expenditure on setting up the business. The applicants’ expectation about value cannot be substituted for actual value.

612 I do not adopt the referee’s valuation of the respective businesses as at the dates of the respective franchise agreements.

### **The applicants’ methodology**

613 As noted above, the applicants claimed that their losses were:

- (a) the sum of:
  - (i) the costs they each incurred in setting up the franchises;
  - (ii) the borrowing costs each incurred; and
  - (iii) the net operating losses incurred in running the franchises;
- (b) less the residual value of the businesses.

614 The respondents argued:

The applicants [submit] ... that the Court [should] determine the true value of the business as at the arbitrary date of 31 December 2022. While the conventional principles as to the assessment of damages in a “no transaction” case are not inflexible, the approach suggested by the applicants is not appropriate here because:

- (a) Although the applicants give no evidence as to precisely when they became aware that matters were not as represented it can be inferred that the applicants knew the actual startup costs at the commencement of operation by which time all equipment had been purchased and the gyms had opened their doors and they also knew the income that was being generated in the monthly cashflow within a few months of opening;
- (b) There is no evidence that the applicants could not have disposed of the

business or the assets of the business when they became aware that startup costs were higher than anticipated and income was not as forecast, and the businesses have continued to trade up to the hearing;

- (c) Compensating for startup costs less the residual value of the business as at 31 December 2022, which the Referee determined on an asset basis (1<sup>st</sup> Report [70]), inappropriately rewards the applicants for holding depreciating assets for approximately 5 years.
- (d) Compensating for the outlays on start up costs plus net operating losses less the residual value of the business would result in double compensation because the Referee's findings as to the residual value of the business as at 31 December 2022 were based upon his conclusion that the applicant franchisees' businesses had no goodwill as at 31 December 2022 due to successive years of trading losses: 1st Report [258], [263], Annexure 13, [307], [313], Annexure 16, [360], [365] and Annexure 19;
- (e) The COVID-19 Pandemic caused lockdowns that affected revenue (1st Report [233], [234], [282], [283], [333], [335]). This was an event bearing on the value of the businesses between the entry into the franchise agreements and 31 December 2022 and it was a supervening or extraneous event to the misleading conduct pleaded: see *Kizbeau* at 291 [16].

615 The statutory right of action under s 236 of the ACL is for “the amount of the loss or damage” which the applicant suffered “because of” the misleading conduct. The phrase “because of” is the only express constraint on what may be claimed under s 236. The purpose of damages for a contravention of s 18 is to provide compensation to an applicant who altered its position because of misleading conduct. The purpose can be achieved by putting the applicant in the position in which it would have been had the contravening conduct not occurred, so far as that can be done by monetary compensation.

616 Section 236 is free from any direct restraint of common law rules restricting or reducing damages, such as contributory negligence or the doctrine of mitigation: *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* [2002] HCA 41; 210 CLR 109 at [85]. It is wrong to begin the inquiry about remedies under s 236 by attempting to draw an analogy with a claim under the common law or to allow the analogy to control the inquiry: *Murphy v Overton Investments Pty Ltd* [2004] HCA 3; 216 CLR 388 at [44].

617 Nevertheless, the assessment of damages for the statutory purpose may be informed by a consideration of common law principles for the assessment of damages, particularly where those principles relate to a claim with a close analogy to the claim being considered such as a claim for misrepresentation – see, for example: the consideration of *Potts v Miller* (1940) 64

CLR 282 in *Wardley Australia Ltd v State of Western Australia* [1992] HCA 55; 175 CLR 514 at 530 and *Astonland* at [35]-[40].

618 The submission that the applicants’ methodology “inappropriately rewards the applicants for holding depreciating assets for approximately 5 years” should be rejected. The losses were in fact incurred “because of” the respondents’ conduct. There is no loss separate to the loss occasioned because of the respondents’ conduct which can be seen to have been caused by the applicants – see: *I & L Securities* at [89]. The trading losses cannot be seen as relevantly caused because of the applicants’ conduct. Noting that the doctrine of mitigation of damage does not apply, to the extent it is relevant to the statutory cause of action under s 236, it was not unreasonable for the applicants to continue to operate the businesses. Indeed, it was entirely reasonable in the circumstances. The applicants were locked into arrangements with the franchisors and into an endeavour to operate a business concept which had just been introduced into the Australian market. It would not have been obvious from the very outset that the businesses would continue to be unprofitable for an extended period. For example, it would have been reasonable to assume that member numbers would improve, including after the initial cancellations around the time of opening. The decision to continue trading would have been influenced by a multitude of considerations, including the terms of leases of premises, guarantees which had been given and financial arrangements entered into in connection with the businesses. At least two of the Balcatta applicants had, for example, given personal guarantees in relation to the Life Fitness equipment and bank guarantees had been obtained by each corporate applicant in relation to the respective leased premises. Further, it is unlikely that the applicants could have sold the unprofitable businesses for any significant amount, at least to a reasonable and knowledgeable purchaser. It is relevant also to note that this litigation was commenced reasonably promptly and conducted with reasonably efficiency.

619 Contrary to the respondents’ submission, compensating the applicants for the expenditure on start-up costs and net operating losses less the residual value of the businesses as at 31 December 2022 does not result in double compensation. Rather, it places the applicants in the position in which they would have been had the contravening conduct not occurred.

620 The COVID-19 pandemic caused longer lockdowns in Sydney than in Perth. Its impact was mitigated by various Federal and State Government responses. It may in fact have improved overall profitability of the Balcatta Franchise, this being the referee’s conclusion. It was not a supervening or extraneous event which should be taken into account in assessing losses. To



the extent it increased net operating losses of the franchises, it cannot be regarded as separately causing a distinct part of the damage suffered by the applicants; rather it played *a* part (together with the respondents' misleading conduct) in the applicants' entire loss – see: *I & L Securities* at [89]. The losses of the franchisees may have been greater in some years because of the pandemic but that does not operate to reduce the respondents' liability for losses sustained by the applicants "because of" the respondents' conduct. No losses would have been incurred had it not been for the respondents' conduct. All sorts of external factors, both positive and negative, affected profitability. It is artificial and contrary to the terms and purpose of s 236 of the ACL to take into account increases or decreases in profitability caused by the COVID-19 pandemic in circumstances such as the present.

621 Contrary to the respondents' submission, choosing the date of 31 December 2022 to value the businesses is not relevantly "arbitrary". It was plainly selected as a date proximate to the trial when financial records might be available in order to make a better informed assessment of value in applying a methodology designed to compensate the applicants for losses sustained because of the respondents' conduct, taking into account the advantages gained by entering into the franchise agreements.

622 In principle, each of the applicants is entitled to losses and damages calculated in accordance with the methodology they submitted to be appropriate.

623 It is necessary then to address the position of each of the corporate applicants and whether the referee report should be adopted in respects relevant to those applicants.

### **Balcatta Franchise**

624 The referee concluded that the start-up costs for the Balcatta franchisee were \$1,399,184 being the capital expenditure of \$1,153,811 and \$245,373 initial net expenditure: 1<sup>st</sup> Report at [91], [92], [133] and [134]. I adopt these conclusions.

625 The referee found that the Balcatta applicants' costs of borrowing were \$97,067: 1<sup>st</sup> Report at [64] and [88]. All parties accepted this as correct. I adopt this conclusion.

626 It was submitted by the respondents that the Court ought not accept the referee's findings as to operating losses for the Balcatta Franchise because the records upon which the findings were based were unreliable.

627 This submission was advanced by reference to the cross-examination of Mr K Girgis during which he was taken through a number of financial documents, the provenance of some of which was left unexplained. He was cross-examined, for example, on Xero records extracted by the respondents who had been granted access to those records. The process by which those records were extracted was not the subject of evidence.

628 I reject the respondents' submission. ACS192: The referee was aware of, and considered, differences which existed between the Xero records and the financial accounts and difference between the financial statements and the income tax returns: Exhibit 22 at A26. The referee was provided with further information. The referee concluded at [110] of his 1<sup>st</sup> Report as follows:

Based on my review, in the majority of instances, the amounts detailed in the Xero records exactly match the amounts shown in the financial accounts. Where differences arose, being mainly for the Balcatta franchise, these appear to relate to timing differences. Overall, I consider that the differences identified between Xero records and the financial accounts will not have a serious impact on my conclusions regarding the start-up costs, borrowing costs and operating profits and losses of the Applicant Franchise businesses.

629 The reference in that paragraph to the Balcatta franchise is a reference to the fact that the referee was unable to reconcile the income and expenditure recorded in Xero with the profit and loss in the Balcatta financial reports, finding a net difference of \$20,953 for the 2018 financial year: 1<sup>st</sup> Report at [98], [99].

630 The referee's 1<sup>st</sup> Report reveals a careful consideration of the material provided. The referee sought and was provided with information sufficient for him to express opinions on the questions asked of him in relation to the Balcatta Franchise including the operating losses.

631 It is true that there was a discrepancy in relation to the Balcatta Franchise between the Xero records and the financial accounts which the referee was not able to resolve. The referee concluded that the discrepancy would not significantly impact his conclusions. The existence of such discrepancies is hardly unusual. There would have been discrepancies, perhaps more, if the issues had been litigated in Court through competing experts. The discrepancy does not provide an appropriate justification for rejecting the conclusions about net operating losses having regard to the various consideration identified by McDougall J in *Westpoint* set out above.

632 The respondents contended that the Balcatta Franchisee should only be compensated with respect to its losses in the first 12 months of operation because "all representations about

cashflow were made for the first 12 months of operation (not including pre-sale)”. I reject this submission. If the respondents had not engaged in misleading conduct, the Balcatta applicants would not have become contractually bound to the various obligations arising under the franchise agreement and guarantees and would not have been placed in the position of having unprofitable businesses to run.

633 There is no principled reason to confining losses arising “because of” the respondents’ conduct to a period of 12 months. It is not to the point that the cash flow which had been prepared was for a 12 month period. The misleading conduct related to what was referred to by the parties at the time as “start-up costs” or “establishment costs”, a component of which was the costs for “lease or purchase of equipment”. By way of example only, one significant necessary expense which was overlooked by the Balcatta applicants because of the respondents’ conduct was an ongoing monthly lease payment (for about 48 months) for Life Fitness equipment which the Balcatta applicants had understood to be included in the estimated range of start-up costs of \$800,000.

634 The referee’s conclusions were not arbitrary, or influenced by improper considerations; they were the result of a process of logic and the application of a considered mind to the factual circumstances. I adopt the conclusions as to the net operating losses of the Balcatta Franchise.

### **Blacktown Franchise**

635 The referee found that the start-up costs for Blacktown were \$1,394,205 comprised of capital expenditure of \$1,284,445 recorded in its balance sheets and \$109,769 net expenditure recorded in its profit and loss statements: 1<sup>st</sup> Report [91], [92], [157] and [158]. I adopt these conclusions.

636 The borrowing costs found by the referee to have been incurred by the Blacktown franchisee were \$148,543: 1<sup>st</sup> Report [64], [88], [92]. I adopt this conclusion.

637 The respondents contended that the referee’s conclusions about operating losses should not be adopted. As had occurred with Mr K Girgis, Mr Kim was cross-examined by reference to a folder of financial documents. For example, he was cross-examined on an amended tax return marked “Not complete” and unsigned financial statements: Exhibit 14. The status of the material was often not explained to Mr Kim in cross-examination. Rather, a series of documents was put to Mr Kim which, on one view, were inconsistent. The significance of the inconsistencies to an assessment of the reliability of the referee’s conclusions or the referee’s

reliance on the material he relied upon was not made apparent. By way of example only, it is hardly surprising that there might exist a draft or incomplete document which differs from the final version of that or another document. The respondents observed, for example, that the signed and unsigned versions of the financial report for the year ended 30 June 2018 contained different operating expenses and that other documents also revealed different operating expenses. One would think that is what is to be expected in a draft.

638 Ultimately, none of the matters raised by the respondents on this topic detracts from the analysis of the referee in any way which suggests that his conclusions with respect to operating losses should not be adopted.

639 The respondents submitted:

Mr Kim was uncertain about whether the amended income tax return for 2018 he had prepared had been lodged: T417.21-22. Given the amended tax returns were prepared immediately before the hearing, one would have expected Mr Kim to be aware if they had been. Mr Kim's silence in his evidence in chief suggests that nothing he could have said about the late preparation of the tax returns showing substantially increased expenses or their lodgement would have assisted his case: *Commercial Union Assurance Co of Australia Ltd v Ferrcom Pty Ltd* (1991) 22 NSWLR 389, 418 – 419.

640 As to the first sentence of this submission, the document which Mr Kim was taken to was an amended tax return for 2018 marked "Not complete", although this fact was not drawn to his attention. He was asked whether that document had been lodged to which he responded "I don't know": T417.21. He was then asked whether amended tax returns were lodged in March 2023 for the 2019, 2020 and 2021 financial years, to which he immediately responded that they had been: T417. He was not asked whether a final amended tax return for the 2018 financial year had been lodged.

641 As to the second sentence of this submission, it proceeds on a false assumption that Mr Kim had stated he was not aware whether amended returns had been lodged. He was aware. He stated that they had been for the 2019 to 2021 financial years. He was not asked about a final amended tax return for the 2018 financial year.

642 As to the third sentence, it was not put to Mr Kim that the expenses were artificially inflated or fabricated and it was expressly stated during cross-examination that there would be no issue of fabrication: T423.9.

643 Mr Kim's evidence was only remarkable for the care given to the accuracy of his answers.

644 It is also relevant to note why there were amended tax returns. On 9 November 2022, the referee was provided with material which included an expert report which had been prepared by the respondents' expert, Mr Russell. On 29 November 2022, the referee requested (see: Exhibit 22 at 3):

We draw your attention to the following matters included in our information request:

- We have requested that the Parties confirm that their respective accountants responsible for preparation of the financial accounts have been provided with copies of the Reports of Mr Russell dated 30 November 2021 and 13 May 2022; and
- That the Parties obtain confirmation from their accountants:
  - That they consider the financial accounts do not require any adjustment for the matters raised by Mr Russell, with explanatory details as appropriate;
  - Or, if adjustments are required, details of the adjustments required.

645 On 25 January 2023 the applicants' solicitors responded to the referee providing responses from the applicants' accountants to Mr Russell's concerns. This response confirmed various adjustments were considered appropriate having regard to the concerns expressed by Mr Russell: Exhibit 22 at 18-20.

646 After the request which had been made by the referee had been answered with information provided by the Blacktown Franchisee's accountant, the accountant amended the income tax returns to align the returns with the restated financial statements: Exhibit 22 at 38.

647 As it had with respect to the Balcatta Franchise, the respondents submitted that the Blacktown Franchisee should only be compensated with respect to its losses in the first 12 months of operation because "all representations about cashflow were made for the first 12 months of operation (not including pre-sale)". This submission is again rejected. There is no proper basis not to compensate the Blacktown Franchisee for all of its losses caused by entering into the transaction. It is not to the point that one aspect of the respondents' misleading conduct was to provide a misleading prediction of cash flows for 12 months. Indeed, the respondents' conduct carried the implication that cash flows of that order would continue beyond the initial 12 months.

648 The referee's report should be adopted in relation to the net operating losses of the Blacktown Franchise.

## Castle Hill Franchise

649 The referee found that the start-up costs for Castle Hill were \$1,448,264 comprised of capital expenditure of \$1,254,702 recorded in its balance sheets and \$193,562 net expenditure recorded in its profit and loss statements: 1st Report [91], [92], [182] and [183]. I adopt those conclusions.

650 The borrowing costs found by the referee to have been incurred by the Castle Hill franchisee were \$62,897: 1<sup>st</sup> Report [64], [88], [92]. The respondents submitted that, although the referee had not included motor vehicles and financing costs in the valuation of the business, it appeared that the referee had not excluded the interest related to those motor vehicles from the borrowing costs included in the profit and loss statements – see: 1<sup>st</sup> Report at [372].

651 The respondents submitted, and I accept that, Mr Mirdjonov conceded the following:

- one of the motor vehicles was not for business purposes: T381.20-24;
- the other vehicle was predominantly not business related: T381.26-30;
- the vehicles had related interest expenses: Exhibit 12 at 6266;
- the company AMEX card was used to finance expenses unrelated to the business: T389.5; and
- the company paid interest for expenses unrelated to the business: Exhibit 12 at 6267, 6326, 6329, 6330, 6333 and 6334.

652 The respondents submitted that it is therefore likely that borrowing costs assessed by the referee are to some extent inflated on account of expenses unrelated to the business. I accept this is likely to be correct, but note that the amount is likely to be only slightly inflated.

653 In relation to operating losses, the respondents submitted that the referee relied on the accuracy of the financial accounts provided to him and that the accuracy of the Castle Hill accounts cannot be trusted.

654 As with the other applicant franchisees, there were unexplained discrepancies and anomalies in the financial records kept by the Castle Hill Franchisee which the referee identified – see, for example: Exhibit 25 at 6951-6952.

655 If this were the only issue, I would incline towards adopting the referee's report about net operating losses because he considered these discrepancies did not materially impact his assessment. However, it is not the only issue.

656 The respondents properly submitted that the circumstance concerning the Castle Hill Franchisee were different from those concerning the Balcatta and Blacktown Franchisees, because it was established that substantial expenses which were not related to the business were recorded in the accounts provided to the Court and to the referee: T378-9. It was submitted that the referee was unaware of the extent of the unrelated business expenses and that “[h]ad Mr Mirdjonov been forthcoming with the referee, it is unlikely the referee would have been satisfied that he could rely upon the financial records provided to him without further inquiry”. The respondents submitted:

The expenses which Mr Mirdjonov conceded were unrelated to the business could potentially be identified and excised from an assessment of loss. But they expose a more fundamental difficulty, namely, whether there may be other expenses unrelated to the business hidden away in the books of the company. The respondents could not undertake a full audit in cross-examination of the company’s financial records and the Referee has not had the time to do one. In those circumstances, significant doubt is cast on the reliability and truth of what is recorded in the Castle Hill franchisee’s financial records.

657 The Castle Hill applicants accepted that expenses unrelated to the gym business should be excluded and, specifically, that the whole of the “Meeting Expense” should be excluded, totalling \$70,653, for the years ended 30 June 2019 to 30 June 2022. However, I note that personal or non-business expenditure was also included in “General Expenses”: Exhibit 12 at 6254-6.

658 The Castle Hill applicants submitted that the referee excluded national and international travel and financing (both director loans and third party financing) and surplus cash and motor vehicles, considering these to be “non-business assets”, referring to the 1<sup>st</sup> Report at [356] and [371]. This submission is not accurate. It is accurate to state that these things were excluded for the purpose of valuing the business as at 31 December 2022. It is inaccurate without observing that those amounts were not apparently excluded for the purpose of determining net operating losses or what the referee referred to as “operating costs”.

659 Ultimately, I am not satisfied that the referee’s report reflects an accurate assessment of the net operating losses of the Castle Hill Franchise, because the referee’s assessment of those losses is likely to include substantial amounts of personal or non-business expenditure.

660 This does not mean, as the respondents submitted, that no damages should be awarded for net operating losses. That might have been an appropriate response in different circumstances. I will hear further from the parties as to an appropriate solution for determining the net operating

losses of the Castle Hill Franchise and an appropriate amount for borrowing costs. One solution may be to pose further questions to the referee.

### **MSA FEES**

661 The claim in respect of MSA fees was abandoned in closing submissions. It follows that Issues  
14 to 20 do not require determination.

### **CONCLUSION**

662 The Court should adopt parts of the referee's report as indicated earlier.

### **Balcatta Franchise**

663 The franchise agreement should be declared void. The guarantees given by Mr K Girgis, Mr  
S Girgis and Mr Chau should each be declared void. An order should be made against each  
respondent for compensation for losses in an amount of \$1,744,816 and interest from 31  
December 2022 until the date of judgment.

### **Blacktown Franchise**

664 The franchise agreement should be declared void. The guarantee given by Mr Kim should be  
declared void. An order should be made against each respondent for compensation for losses  
in the amount of \$1,906,783 and interest from 31 December 2022 until the date of judgment.

### **Castle Hill Franchise**

665 The franchise agreement should be declared void. The guarantee given by Mr Mirdjonov  
should be declared void. An order should be made against each respondent for compensation  
for losses in the amount of \$1,448,264 and interest from 31 December 2022 until the date of  
judgment. I will hear further from the parties in relation to appropriate orders for quantification  
of net operating losses and borrowing costs in relation to the Castle Hill Franchise.

I certify that the preceding six  
hundred and sixty-five (665)  
numbered paragraphs are a true copy  
of the Reasons for Judgment of the  
Honourable Justice Thawley.



Associate:

A handwritten signature in black ink, consisting of a stylized 'A' followed by a horizontal line.

Dated: 5 May 2023

## **SCHEDULE OF PARTIES**

**NSD 395 of 2020**

### **Applicants**

Fourth Applicant:	PAUL CHAU
Fifth Applicant:	ACTIV HEALTH CLUBS PTY LTD
Sixth Applicant:	RICHARD KIM
Eighth Applicant:	ADVANCED CLUB MANAGEMENT PTY LTD
Ninth Applicant:	LAZIZ MIRDJONOV

### **Respondents**

Fourth Respondent:	MEMBERSHIP SERVICES AUSTRALIA PTY LTD
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