

# SUPPLEMENTARY SUBMISSION

## FEDERAL CHAMBER OF AUTOMOTIVE INDUSTRIES

### 1 Executive Summary

This supplementary submission to the review of the Franchising Code of Conduct (**Code**) by Dr Michael Schaper (**Review**) should be read in conjunction with the detailed submission by the Federal Chamber of Automotive Industries (**FCAI**) previously provided. This supplementary submission addresses the interaction of settled legal principles and the Code and responds to particular recommendations made by the Motor Trades Association of Australia on behalf of their dealer members which seek to change the law, create new financial entitlements and further increase the regulation of automotive dealership and franchise arrangements.

The FCAI's position in relation to the Code, and suggestions for further amendments, is as follows:

1. The Code, and the Review, must have regard to the overall regulatory framework, which is extremely comprehensive and includes:
  - a. The Code's pre-contractual disclosure process, which not only has comprehensive information disclosure requirements but statutory time periods to allow for considered decision making and obtaining legal and business advice;
  - b. The Code's statutory good faith obligation;
  - c. The existing provisions of the Code that only apply to new car dealership agreements, and already address (in a manner that largely codifies existing legal rights and market practice) expectations in the context of market withdrawal, network rationalisation and change of distribution models;
  - d. The common law, including the law of contract and equitable principles that permit terms to be implied into contracts where necessary to give them business efficacy or reflect the intent of the parties;
  - e. Prohibitions on misleading or deceptive conduct and unconscionable conduct contained in the Australian Consumer Law (**ACL**); and
  - f. Prohibitions on unfair contract terms in standard form small business contracts, also contained in the ACL.

Each of these laws enhances and supports the contractual process. Together there is a comprehensive framework to ensure the integrity of the contractual process between independent businesses. Substantial penalties and other sanctions apply to any breach of these laws. Further, the entire regulatory framework is overseen by the Australian Competition and Consumer Commission (**the ACCC**), which is a well-resourced and highly effective regulator.

2. The only further amendments to the Code should be those described in Part 3 of the FCAI's main submission, which clarify compliance obligations and simplify compliance without derogating from the intended protection.
3. The purpose of the Code is **not** to alter the contractual bargain fairly made between independent business parties. Changes to the Code to create new financial or compensation entitlements or new contractual rights where none currently exist go well beyond providing "*regulatory support for the industry*" and would give commercial advantage to one party over another. There is no "*misconduct or opportunistic behaviour*" to be addressed, and the changes do not "*drive competitiveness, sustainability and productivity*".
4. The Code should not be amended in circumstances where the current law is clear and certain, or to create an entitlement to compensation on grounds that have been considered in detail and rejected by the courts. High Court and Federal Court authority has clearly settled how the law applies in the context of end of term entitlements, goodwill, good faith, unconscionable conduct, damages and compensation. Any change to the law in these areas would override existing settled law and create legal uncertainty where none currently exists.

5. The FCAI specifically rejects:

- a. Automatically extending the Code to apply to all automotive aftermarket repairers, and all service and parts agreements. If such arrangements are set up as a franchise, they will be caught by the general definition of a “franchise agreement” contained in the Code. If the agreements are collateral to an existing dealer agreement, the dealer will be protected by the provisions of the Code that apply to new car dealership agreements. There are various types of independent automotive aftermarket repairers that could well be caught by any amendments. Similarly, parts are provided to various different types of businesses, not just motor vehicle dealerships.
- b. Creating a new definition of goodwill beyond that currently known at law, and attaching a compensation entitlement to rights the dealer does not in fact have at law.
- c. Creating a new right to transfer an automotive franchise agreement for an artificially inflated value or receive equivalent amount in compensation where the franchise has expired and is not extended. The Code already provides in clause 23 that if a franchise is not extended the dealer is no longer bound by the non-compete provisions in the dealer agreement. This enables the dealer to fully realise any goodwill that relates to the dealer, such as goodwill in relation to the location of the business and personal goodwill of the dealer. It is settled law, recently reconsidered and affirmed in the Mercedes Case, that the franchisee is not entitled to goodwill pertaining to an expired franchise agreement, or for that matter any lease, licence agreement, franchise agreement or any other agreement with a defined duration.
- d. Deleting the ability, acknowledged by clause 28 of the Code, for the parties to an automotive franchise agreement to agree that the franchise agreement can be terminated on reasonable notice. In this context it should be noted that reasons must be provided, and that (due to the prohibition on unfair contract terms) the termination provision would likely be required to permit termination by either party. The FCAI also notes that a number of motor vehicle dealership agreements have no fixed end date. Accordingly, the ability to terminate on reasonable notice is commercially and legally essential.
- e. Mandating a minimum 5 year term for all motor vehicle dealership agreements on the basis such a provision is unnecessary and will significantly impact competition and the interests of Australian consumers.
- f. Creating unnecessary confusion by blurring current Federal legislation concerning unfair contract terms and unconscionable conduct, and creating a new concept of “unjust conduct”.
- g. The creation of a new List to the Federal Circuit Court of Australia, as this would not enhance the current dispute resolution or court framework and would simply create jurisdictional uncertainty.

## 2 Assessing Fitness for Purpose – the automotive provisions

The Code is a mandatory industry code established to provide “*regulatory support for the industry to guard against misconduct and opportunistic behaviour, while fostering long term changes to business culture that can drive competitiveness, sustainability and productivity.*”<sup>1</sup> The Code’s purpose has also been previously expressed to be to assist franchisees to make an informed decision prior to entering

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<sup>1</sup> Australian Government, ‘*Review of the Franchising Code of Conduct*’, Consultation Paper, August 2023, p. 7.

into a franchise agreement, provide a framework for dispute resolution and regulate the conduct of participants in franchising<sup>2</sup>.

The intent of Parliament is clear – that the Code should support the commercial intent of the parties and the contractual process, protect against misconduct, provide information to assist parties to the contract, enable considered decision making and enhance competition and the interests of consumers.

The automotive provisions of the Code seek to strike a balance between the need to enable business parties to fairly transact on such commercial terms as they shall consider appropriate, and the desire to prevent identified circumstances where misconduct or opportunistic behaviour could be possible. They do not create new financial entitlements, as the circumstances in which they apply are limited to circumstances where one would expect there to be an existing right. Clause 46A provides that compensation is only payable:

1. If the agreement is terminated before it expires; and
2. Termination is because the franchisor withdraws from the Australian market, rationalises its Australian network or changes its Australian distribution model.

It would clearly be opportunistic if a franchisor terminated the agreement before both parties had otherwise agreed it should expire in the limited circumstances described in clause 46A. Similarly it is clearly not “opportunistic” or “misconduct” if a franchisor, or a franchisee, terminated the agreement at the expiry of the agreement, or on circumstances contemplated by the express provisions of the agreement. Requests for further amendments to the Code that create new financial entitlements or alter the commercial bargain between the parties should be rejected, as they are inconsistent with the purpose of the Code.

The vast majority of automotive dealers are significant businesses run by experienced business people, so there is no justifiable basis for asserting that they have any particular legal vulnerability. Automotive distributors and dealers should be free to contract on such terms as they see fit, subject only to the regulatory framework that supports the contractual process. As noted above, the regulatory framework is extremely comprehensive, and features:

1. The Code’s pre-contractual disclosure process, which not only has comprehensive information disclosure requirements but statutory time periods to allow for considered decision making and obtaining legal and business advice;
2. The Code’s statutory good faith obligation, which has been specifically augmented in relation to new vehicle dealership agreements by requiring a court to have regard for the purposes of considering good faith as to “*whether the terms of the agreement are fair and reasonable*”<sup>3</sup>. (Somewhat ironically, this amendment to the Code not only provides significant additional protection to dealers, but actually demonstrates that the further amendments sought by the MTAA are not in fact “*fair and reasonable*”. Otherwise they would already be protected by clause 6(3A) of the Code. What the MTAA is seeking to achieve is to secure commercial advantage, not address unfair or unreasonable provisions or misconduct);
3. The existing provisions of the Code that only apply to new car dealership agreements, and already address expectations in the context of market withdrawal, network rationalisation and change of distribution models<sup>4</sup>. The FCAI notes that the legislation largely codifies existing legal rights and market practice. Few if any dealer agreements would actually contain clauses that permit a franchisor to terminate the dealer agreement for market withdrawal,

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<sup>2</sup> Currently reflected in part in clause 2 of the Code, and in previous versions of the statement of purpose in the Code.

<sup>3</sup> See clause 6(3A) of the Code.

<sup>4</sup> The AADA in fact welcomed these reforms in a release on 1 June 2021 that “*these changes will bring a degree of balance to the relationships between new car Dealers and the Manufacturers to which they are franchised.*”

network rationalisation or change of distribution models. As noted above, those provisions focus on unusual circumstances where an agreement is terminated “before it expires”<sup>5</sup>;

4. The common law, including the law of contract and equitable principles that permit terms to be implied into contracts where necessary to give them business efficacy or reflect the intent of the parties;
5. Prohibitions on misleading or deceptive conduct and unconscionable conduct contained in the Australian Consumer Law (**ACL**); and
6. Prohibitions on unfair contract terms in standard form small business contracts, also contained in the ACL. If dealer agreements are somehow exempt from the prohibitions on unfair contract terms, they will for all practical purposes be caught by clause 6(3A) of the Code, which requires good faith to be considered in the context of whether provisions are “fair and reasonable”.

Substantial penalties and other sanctions apply to any breach of these laws. Penalties for breach of the Code are also very high by world standards, and indeed when compared to other laws. Almost every provision of the Code carries a pecuniary penalty of 600 penalty units (currently \$165,000) per breach. The core automotive provisions in the Code attract a higher penalty, being the greatest of:

- \$10 million; or
- where the value of the benefit attributable to the breach can be ascertained, three times the value of that benefit; or
- where the value of the benefit attributable to the breach cannot be ascertained, 10 per cent of the annual turnover.

Any individual involved in a breach of these provisions can face a civil penalty of \$500,000.

The Code supports the contractual bargain fairly made between independent businesses. It is not the role of the Code to create new financial or commercial entitlements that would contradict existing and well settled legal principles. Similarly, it is not the role of the Code to protect a party from competition or change, even if there could be adverse commercial consequences. The Code, and the law under which it was enacted, must promote competition and the interests of Australian consumer.

### 3 Goodwill

The FCAI rejects the notion that the law is somehow unclear or does not correctly deal with the concept of goodwill. On the contrary, the law in this area is settled, and supported by a long line of authority that includes the decision of the High Court of Australia in *Federal Commissioner of Taxation v Murry*<sup>6</sup> (**Murry’s Case**) and the decision of the Federal Court of Australia in *Ranoa Pty Ltd v BP Oil Distribution Ltd*<sup>7</sup> (**Ranoa**). Further, the issues raised by the MTAA have also been considered very recently in the case of *AHG WA (2015) Pty Ltd v Mercedes-Benz Australia/Pacific Pty Ltd*<sup>8</sup> (**the Mercedes Case**).

In summary, the law makes it clear that goodwill relating to a lease, licence agreement, franchise agreement, dealer agreement and any other agreement that has a defined term is inextricably linked to the duration of the agreement. Goodwill subsists for the term of an agreement, and cannot continue beyond expiry of that agreement. So if a party is for some reason entitled to compensation, the measure of compensation is calculated by reference to the remaining duration of the agreement.

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<sup>5</sup> Clause 46A was introduced to address dealer concerns with potential implications of Holden’s withdrawal from the Australian market, but the Holden dealer agreements were in fact not terminated unilaterally by Holden. For the vast majority of Holden dealers, termination occurred by agreement between Holden and the dealer, with such agreements also providing for payment of agreed compensation for the cessation of new Holden vehicle sales.

<sup>6</sup> (1998) 193 CLR 605.

<sup>7</sup> (1989) 91 ALR 251.

<sup>8</sup> [2023] FCA 1022.

There are other forms of goodwill recognised by the law, and also clearly understood. For example, goodwill can apply to a particular location, to the reputation of a particular business, to the skills of a particular employee and so forth. A brand owner has goodwill in the brand, and in products produced under the brand. The brand owner can give another party rights that can give rise to goodwill – for example the right to distribute those products in a particular region for a period of time. This framework is not only well understood, it has been forever at the heart of arrangements for the distribution of goods and services in market economies around the world.

Arguments seeking to extend the financial entitlements of parties who have been given the right to distribute goods or services have been thoroughly considered by the courts, most recently in the Mercedes Case, and rejected. The MTAA Submission seeks to create some new concept of “established goodwill”, and then seek to attach compensation to this new concept. The FCAI makes the following points in relation to this request:

1. Goodwill is already recognised by the law. As noted above, Australian courts have clearly established the basis for calculation of goodwill in all circumstances, including in relation to dealer agreements.
2. Any regulatory change would completely change well established legal precedent and introduce uncertainty where none currently exists.
3. The term “established goodwill” seeks to create some new form of goodwill that is separate from the rights granted by the dealer agreement. In the Mercedes Case the applicant dealer sought to argue that it had ongoing rights in perpetuity, and the non-renewal power could only be exercised if the dealer failed to meet targets or undertake mutually agreed improvements. The court rejected that argument, also rejecting the allegation that Mercedes had failed to act in good faith or had acted unconscionably.
4. The MTAA Submission in the context of goodwill is similar to the efforts by the dealer applicant in the Mercedes case, which the court summarised as follows:

*‘The applicants in essence seek to rewrite the contractual bargain struck by the dealer agreements into one which better suits their commercial interests’<sup>9</sup>.*

The FCAI rejects calls to create a new right to transfer an automotive franchise agreement for an artificially inflated value or receive an equivalent amount in compensation where the franchise has expired and is not extended.

The Code already provides in clause 23 that if a franchise is not extended the dealer is no longer bound by the non-compete provisions in the dealer agreement. This enables the dealer to fully realise any goodwill that relates to the dealer, such as goodwill in relation to the location of the business and personal goodwill of the dealer. It is settled law, recently reconsidered and affirmed in the Mercedes Case, that the franchisee is not entitled to goodwill pertaining to an expired franchise agreement. This ought to be no surprise, as the law applies in the same manner to any lease, licence agreement, franchise agreement or any other agreement with a defined duration.

There is one further issue that the FCAI would like to address. We note that a number of dealer associations have stated that Mr Justice Beach in the Mercedes Case “*called for the reform of the Franchising Code*”. This is an unjustified extrapolation from his comments that consideration of the terms of the Franchising Code is “*a matter for another day and another forum*”. The actual comments by Beach J are set out below:

*... given the facts of this case leading to an adverse result for the applicants, it may be that further consideration needs to be given to the terms of the franchising code and possible modification, but that is a matter for another day and, obviously, in another forum.*

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<sup>9</sup> The Mercedes Case, paragraph 44

## 4 Duration of Agreements

### Termination on reasonable notice and with reasons

It is fundamental to the proper functioning of Australia's market economy that independent business parties seeking to transact ought to be free to do so on such terms as they fairly consider appropriate. As noted above, the law intervenes to address information imbalances, prevent misleading or deceptive or unconscionable conduct, require parties to act in good faith and prevent unfair contract terms. The law should not intervene in relation to fundamental commercial terms that are transparent and obvious, such as in relation to the duration of an agreement, or the rights of the parties to bring the agreement to an end in certain circumstances.

The FCAI rejects calls to delete the essential right and ability, acknowledged by clause 28 of the Code, for the parties to an automotive franchise agreement to agree that the franchise agreement can be terminated on reasonable notice. In this context it should be noted that reasons must be provided, and that (due to the prohibition on unfair contract terms and clause 6(3A) of the Code) the termination provision would likely be required to permit termination by either party.

This is not only commercial fair and reasonable, but legally essential in some cases. The FCAI notes that a number of motor vehicle dealership agreements have no fixed end date. Accordingly the ability to terminate on reasonable notice is legally essential.

Product distribution arrangements across all areas of commerce will often feature a provision permitting termination on reasonable notice, and there is extensive legal precedent as to what may be "reasonable" in all the circumstances. It is important that automotive and franchising arrangements operate on a consistent legal footing with other product distribution arrangements, and permit contractual freedom in relation to fundamental commercial terms. This issue was recently addressed in the Mercedes Case, where the applicants sought to argue that the dealer agreements could not be terminated on notice, despite there being an express written provision permitting this to occur. The court dismissed this argument, observing as follows<sup>10</sup>:

*"... the applicants in essence seek to rewrite the contractual bargain struck by the dealer agreements into one which better suits their commercial interests. They seek to convert the commercial judgment they made when they entered into those agreements into a guarantee of permanent tenure (subject to certain qualifications that it is convenient for them to concede) and a fetter on the exercise by MBAuP of its legitimate business judgment as to how best to adapt to a changing marketplace concerning the Mercedes-Benz brand in Australia."*

### Minimum 5 year term

It is essential for the effective functioning of the market, and protecting the best interests of consumers, that parties can adapt to change. The automotive sector is undergoing a period of significant change, with new means of propulsion, new products, technological innovation and new competitors. Mandating a minimum 5 year term for all motor vehicle dealership agreements is not only unnecessary, but will significantly impact competition and the interests of Australian consumers. Although dealers may see that it advantages them economically, it will also unfairly advantage new market entrants that seek to establish different or more efficient distribution arrangements.

The MTAA Submission implies that a minimum 5 year term is needed for dealer agreements to permit dealers to secure a return on investment.<sup>11</sup> The Code already provides in clause 46B that a dealer agreement must provide the franchisee with "a reasonable opportunity to make a return, during the term of the agreement, on any investment required by the franchisor". Clause 46B addresses the legitimate concern that a dealer could (at least theoretically) be required by the franchisor to make a significant capital investment, yet not be granted sufficient tenure to enable the dealer to secure a return on this investment. Prescribing a minimum 5 year term goes well beyond providing this

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<sup>10</sup> Mercedes Case, para 44.

<sup>11</sup> MTAA Submission, p. 4 para [6](i).

protection, and essentially assumes that all dealers have been required to make a substantial investment and need 5 years to secure a return.

The FCAI also notes that a number of dealer agreements have no specified end date. In such circumstances, termination needs to be effected by either party giving a reasonable period of notice. Often franchisor and franchisee both have the same right of termination, and often the same notice period. If a mandatory minimum 5 year term for dealer agreements were enacted, this could have the practical effect of requiring either party to give 5 years' notice of termination. This is, of course, unworkable in all the circumstances.

#### Service agreements and parts

The FCAI also rejects calls to automatically extend the Code to apply to all automotive aftermarket repairers, and all service and parts agreements.

If such arrangements are set up as a franchise, they will be caught by the general definition of a "franchise agreement" contained in the Code. If the agreements are collateral to an existing dealer agreement, the dealer will be protected by the provisions of the Code that apply to new car dealership agreements.

There are various types of independent automotive aftermarket repairers that could well be caught by any amendments. Similarly parts are provided to various different types of businesses, not just motor vehicle dealerships. Arrangements for spare parts and repair are often established on very informal lines, with no prescribed system or business oversight, no separate fees and little or no rights to use intellectual property. Such normal product distribution arrangements should remain unregulated, as there is no need for intervention in such basic commercial arrangements.

#### Other MTAA recommendations

The MTAA Submission recommends that the Code '*provides protections against unfair contracts and unjust conduct as provided to dealers in New South Wales pursuant to the Motor Vehicle Dealers and Repairers Act 2013 (NSW)*'.<sup>12</sup> The FCAI opposes this recommendation, as it would create unnecessary confusion by blurring current Federal legislation concerning unfair contract terms, good faith and unconscionable conduct.

The NSW legislation was introduced before the amendments to the Australian Consumer Law to prohibit unfair contract terms, which now largely cover the field, and apply throughout Australia given the legislation is Commonwealth legislation. Similarly the NSW legislation pre-dates significant amendments to the Code in 2015, 2021 and 2022, including the amendment to the good faith obligation to specifically include a requirement when considering good faith for the terms of a new vehicle dealership agreement to be "*fair and reasonable*". The law in relation to good faith, unconscionable conduct and unfair contract terms provides a comprehensive Federal framework. It is inappropriate that the Federal regulation such as the Code be predicated or designed around largely superseded State legislation. Presently, the Federal regime prohibiting unfair contract regimes addresses the issues contemplated by this recommendation. Most automotive manufacturers would already act on the basis that the unfair contract term regime applies to dealer agreements, rendering this recommendation obsolete.

The creation of a new List to the Federal Circuit Court of Australia is opposed, as this would not enhance the current dispute resolution or court framework and would simply create jurisdictional uncertainty. The present dispute resolution system, whereby parties are encouraged to firstly attempt to resolve the dispute via ADR (namely arbitration) before initiating court proceedings, is sufficient.

#### Concluding remarks

The FCAI is aware of representations made to the Independent Reviewer that make various references to preceding inquiries, and includes selective references to cases including the Mercedes

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<sup>12</sup> MTAA Submission, p. 4 para [6](j).

Case. The FCAI is able to provide a more comprehensive response if required. However, the fundamental point is that these matters have been extensively considered when formulating the Code and the other features of Australia's regulatory framework. The FCAI considers the Code to be fundamentally fit for purpose, and rejects calls for substantive amendments that create new financial entitlements, unfairly impact competition and prejudice the interests of Australian consumers.

The FCAI does consider that there are opportunities to improve the operation of the automotive provisions of the Code. Part 5 of the Code was introduced very quickly, with minimal industry consultation, and has received no substantive parliamentary scrutiny or debate. It was also introduced before the penalties were applied to the provision by subsequent amendment to the Competition and Consumer Act.

The FCAI wishes to ensure that the current provisions correctly reflect the intention of Parliament, as they appear to create new compensation entitlements where none may previously have existed, and run current to recent judicial pronouncements.

Amendments also need to be made to remove ambiguity, enable compliance and facilitate arrangements that franchisors and franchisees would wish to operate outside the scope of the provisions. This is particularly the case given the very onerous penalties that apply to any breach of the provision.

The FCAI's views are set out in Part 3 of its submission, which sets out the existing provisions of the Code, and provides suggested amendments that provide necessary clarity or certainty, address unintended consequences or reflect market reality.