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Franchising Code Review Secretariat Unit
Small and Family Business Division
The Treasury
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By email only: franchisingreview@treasury.gov.au

Submission regarding the 2023 Review of the Franchising Code of Conduct

1. Introduction

- 1.1 V.S. George Lawyers welcomes the opportunity to provide a submission to the 2023 Review of the Franchising Code of Conduct (the Code).
- 1.2 As Principal of the firm, I have been advising clients in the automotive industry for 15 years. I have worked 'in-house' in the legal department of Mercedes-Benz UK Ltd and in Australia, I have advised motor vehicle dealers, industry associations and dealer councils as well as some truck and bus distributors.
- 1.3 Although this submission deals with specific issues regarding the automotive industry and associated reforms to the Code, it is acknowledged that all issues under review are considerable issues facing the franchising sector.
- 1.4 Automotive franchising has been the focus of previous reviews of the Code and the Code now mandates some protections for new vehicle dealership agreements. We believe that these protections are necessary and should continue to be strengthened to better protect automotive franchisees.
- 1.5 We note that the review is focused on the regulation of Automotive franchising with specific reference to:
 - whether the Code protections available to automotive franchisees should be extended beyond new car dealerships;
 - the effectiveness of the 2020 and 2021 reforms which:
 - provided for multi-party dispute resolution and clarified that agency models are captured by the Franchising Code.
 - created new obligations relating to compensation in the event of early termination, and franchisees' capacity to make a return on investment.
 - provided additional protections to apply at the end of a franchise term including notification requirements and processes for winding down.
 - restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure.
 - clarified the operation of the Franchising Code obligation to act in good faith in relation to new car dealerships.

2. Executive summary

2.1 V.S. George Lawyers submit that:

- 2.1.1 Many of the reforms are well intended but are yet to be tested in court. However, through dealer agreement negotiations it appears clear that there will be ongoing interpretation issues associated with the Code which must be addressed;

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- 2.1.2 In particular, the Code in its current iteration does not adequately detail or provide explanation as to how 'loss of opportunity in selling established goodwill' must be determined by a distributor in circumstances of Early Termination by the distributor.
- 2.2 Distributors can continue to exploit the lack of clarity as to 'loss of opportunity in selling established goodwill' and how it is to be calculated on early termination of a franchise agreement.
- 2.3 While distributors are required to specify the underlying principles, assumptions and factors in regard to how compensation for the loss of opportunity in selling established goodwill will be determined, many seek to simply limit compensation.
- 2.4 Any attempt by a distributor to limit compensation for loss of opportunity in selling established goodwill is substantially unfavourable to a dealer and contrary to the good faith obligations required by clause 6 of the Code.
- 2.5 We have not seen multi-party dispute resolution take up under the Code. However, some distributors refuse to communicate with their dealers and refuse to negotiate or discuss issues with Dealer Councils. This indicates that distributors continue to view themselves as having a choice in regard to dispute resolution.
- 2.6 Agency Agreements appear to have been accepted as being covered by the Code.

3. Compensation under the Code

3.1 Clause 46A of the Code states:

- (1) *A franchisor must not enter into a franchise agreement unless the agreement:*
- (a) *provides for the franchisee to be compensated if the franchise agreement is terminated before it expires because the franchisor:*
- (i) *withdraws from the Australian market; or*
- (ii) *rationalises its networks in Australia; or*
- (iii) *changes its distribution model in Australia; and*
- (b) *specifies how the compensation is to be determined with specific reference to the following:*
- (i) *lost profit from direct and indirect revenue;*
- (ii) *unamortised capital expenditure requested by the franchisor;*
- (iii) *loss of opportunity in selling established goodwill;***
- (iv) *cost of winding up the franchised business.*

3.1.1 Pursuant to the Code, there is no limitation placed on the loss of opportunity in selling established goodwill. However, distributors are placing limits on this compensation.

3.1.2 Furthermore, clause 46A(3) clearly states:

A franchisor must not enter into a franchise agreement that contains a provision that purports to exclude any compensation to which the franchisee may be entitled, other

than under the agreement, if the agreement is terminated before it expires other than because the franchisee has breached the agreement.

- 3.1.2.1 We believe that any attempt by a distributor to limit the compensation to which the dealer is entitled should be seen as an attempt to exclude compensation and should a term purporting to limit compensation be included in a franchise agreement, a civil penalty should apply.
- 3.2 Page 31 of the Explanatory Memorandum of the Code states clearly that a manufacturer is:
... *'precluded from including a contractual provision which attempts to deny the dealer compensation if the agreement is terminated early for reasons other than breach by the dealer'*;
- 3.3 We believe that any limitation on the 'loss of opportunity in selling established goodwill' equates to an attempt to exclude or deny compensation.
- 3.4 Many distributors are of the belief that a dealer has no right to be compensated in any circumstances for losing the right to sell the business after the agreement expires.
 - 3.4.1.1 However, this stance conflicts with leading case law. In contract, in determining damages, the Court is entitled to take into account the prospect that the contract would be renewed.
 - 3.4.1.2 Any attempt to limit compensation for loss of opportunity in selling established goodwill would result in the failure to reflect the true value of the established goodwill of the franchisee.
- 3.4.2 In addition to being in conflict with the common law, we believe any limitation to be in breach of clause 6(3A) of the Code.
- 3.5 Any franchisor attempting to limit the loss of opportunity in selling established goodwill through the introduction of an unreasonable and uncommercial term may be deemed to not be acting in good faith.

4. Goodwill, Compensation and Loss of Opportunity

- 4.1 Following the recent determination in *AHG WA (2015) Pty Ltd v Mercedes-Benz Australia/Pacific Pty Ltd* [2023] FCA 1022 (Mercedes Benz), it is clear that goodwill for franchisees is no longer. However, as mentioned by the Honourable Justice Beach, we believe that further consideration needs to be given to the terms of the Code and that possible modifications need to be considered.
- 4.2 As detailed in the *Mercedes-Benz*:
"Goodwill in terms of the legal concept [does] not transcend [any] non-renewal of dealer agreements." at [170]
- 4.3 This clearly brings into question the meaning and depth of the term 'loss of opportunity in selling established goodwill' as currently set out within the Code.

5. Contract is King

- 5.1 The importance of contract law and contractual certainty is paramount for the courts. Common law principles will only be displaced by statutory intervention. In some cases, the common law interpretation is intended, e.g., good faith within the Code.
- 5.2 Loss of opportunity is well understood in the common law. Does it have the same meaning in the Code?
 - 5.2.1 We have tried to suggest it does and this has been rejected by distributors.

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- 5.3 The Code and any future amendments need to clearly define what is meant by 'loss of opportunity in selling established goodwill' to ensure clarity to all parties of a franchising agreement.

6. Customer Data

- 6.1 We consider that at the heart of many disputes, whether it is goodwill, loss of opportunity, good faith or unconscionable conduct is the issue of ownership of customer data.
- 6.2 Ownership of customer data should belong to the business owner who has cultivated the customer. A franchisor should have access to and usage of customer data, and in the automotive industry access is a must having regard to mandatory and voluntary recalls.
- 6.3 However, a distributor or franchisor should not be able to pass this customer data on free of charge to another prospective or newly appointed dealer or franchisee. To do so presents an unfair advantage and unfair appropriation of intellectual property.
- 6.4 In recent Senate Committee hearings, we heard for the first time that distributors consider that they have 'joint' ownership of the customer.
- 6.5 We consider that confirming that the dealer 'owns' the customer and their respective data will have a significant impact in reducing disputes.
- 6.6 The failure to control the use of customer data is leading to exploitation.
- 6.6.1 Distributors are appointing new dealers in a particular territory and either directly, or indirectly, using the customer data to direct all customers to a new dealer. This occurs at the expense of the existing dealer. It is little different to the practice of 'churning' which was frowned upon by the industry and regulators.

7. Unfair Contract Terms

- 7.1 We believe that the unfair contract terms regime should be expanded to include all franchise businesses, regardless of employee numbers or annual turnover.

8. Conclusion

- 8.1 Loss of opportunity in selling established goodwill requires clarity within the Code.
- 8.2 Similarly to the progressive introduction of good faith, loss of opportunity in selling established goodwill must be appropriately defined within the Code. Whether that be as a broader reference to the common law understanding of loss of opportunity, or a strict definition, is a matter to which we defer to the Treasury.
- 8.3 However, it is apparent that without any further clarity in regard to loss of opportunity in selling established goodwill, distributors will continue to attempt to limit compensation, undermining the very point of the Code.
- 8.4 Customer data must be clearly delineated and should remain the intellectual property of dealers as the cultivators of this relationship.
- 8.5 Unfair contract terms should be expanded to capture all franchise businesses.



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