AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

SUBMISSION - SENATE INQUIRY INTO THE REGULATION OF THE RELATIONSHIP BETWEEN CAR MANUFACTURERS AND CAR DEALERSHIP MODELS IN AUSTRALIA

6 NOVEMBER 2020

CONTENT

Section 1

FOREWORD

The Australian Automotive Dealer Association (AADA) is the peak industry advocacy body exclusively representing franchised new car Dealers in Australia. We appreciate the opportunity to provide this submission to the Senate Education and Employment References Committee's Inquiry to investigate the regulation of the relationship between car Manufacturers and car Dealership models in Australia.

There are around 1,500 new car Dealers in Australia that operate more than 3,000 Dealerships. The new vehicle retailing sector employs more than 55,000 people including almost 4,500 apprentices. It contributes over 14 million in community donations nationally, has a total turnover/sales of more than $55 billion and generates more than $2 billion in tax revenue.

These are important businesses which pay tax in Australia, create jobs in Australia, and invest in Australia.

For a number of years, the AADA has been calling for measures to address the power imbalance which exists between local Australian car Dealers and the car Manufacturers to which they are franchised. We continue to believe that we require separate protections from the standard franchising system due to the scale of the investments in this industry and the many factors that make the automotive supply chain unique. Not every Manufacturer treats its Dealers poorly, but the AADA is concerned over the growing reports we are receiving from Dealers aligned to various brands.

General Motors' (GM) recent decision to dump Holden and its Dealers is the most striking example of the poor behaviour exhibited by some offshore car Manufacturers. GM Holden led Dealers to believe that it was here for the long haul, demanding multi-million-dollar investments from some Dealers and allowing the sale of Dealerships to go through not long before its announcement was made. In some cases, Dealers were forbidden by Holden from taking on other franchises. Even more shocking was the compensation offers which were insufficient and left so many businesses vulnerable.

It is clear that the behaviour of GM sets a very dangerous precedent and we are concerned that other Manufacturers looking to change their distribution model will adopt a similar approach. In recent months, we have seen more Dealer terminations as well as a number of agreements being non-renewed, despite Dealers performing above the requirements set by Manufacturers.

Manufacturers in Australia operate in an environment which allows them to enter the market and rapidly appoint a network of Dealers. They benefit from the fact that Dealers take on the lion's share of the risk by investing in facilities, stock and equipment, hiring staff, etc. However, there is no mutual obligation for Manufacturers to treat these investors respectfully or fairly and it is easy for Manufacturers to withdraw from Australia, reduce their Dealer networks and radically change their distribution model.

Although in June, the Government enacted automotive-specific franchise regulations under the Franchising Code – they made only incremental changes and provided Manufacturers with options to work around the regulations.

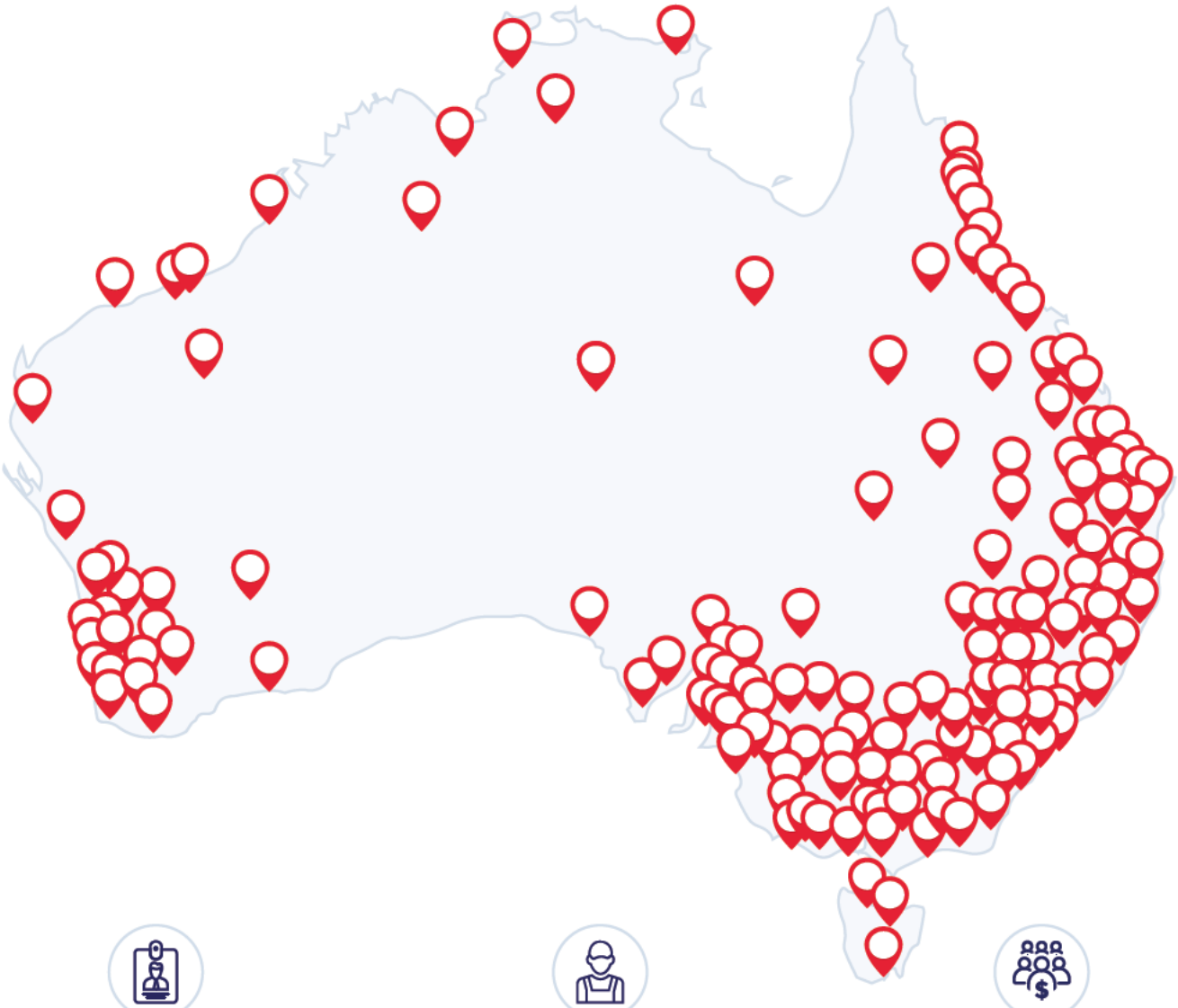
We would urge this inquiry to carefully consider the evidence presented by us and the Dealers of Australia.

James Voortman
Chief Executive Officer

Section 1

Australia

3,135 Dealerships



55,815
Dealer Employees

4,463
Dealer Apprentices

$14.82 million
Community Donations

$5.10 billion
Dealer Wages

$2.07 billion
Tax Contribution

$12.76 billion
Total Economic Contribution

Section 2

AADA KEY RECOMMENDATIONS

1. Security of Tenure: A minimum five-year term for Dealer Agreements or a link between capital investment and the term of the agreement (which will allow Dealers to recover their mandated investments).
2. Provide all franchised new car Dealers with protection against unfair contract terms.
3. Allow for binding arbitration to settle disputes.
4. Obligation on Manufacturers to buy back stock in the event of non-renewal.
5. Protections for Dealers against unfair warranty clawbacks.
6. A principles-based Industry Standard for Compensation for OEMs looking to withdraw from Australia, rationalise their networks or change their distribution models.
7. A definition of vehicle distribution in the regulations which capture future distribution models, including agency models.
8. New end of term obligations (12-month notice and provision of reason for non-renewal) to apply to all agreements – not just those of 12 months and over.
9. Obligation for the franchisor to accede to the franchisees' request for multi-party dispute resolution. The issue of breaching confidentiality clauses in Dealer Agreements by pursuing multi-party dispute resolution needs to be addressed.
10. Appropriate penalties for breaches of the regulations.

Section 3

PRACTICES EMPLOYED BY MANUFACTURERS IN THEIR COMMERCIAL RELATIONS WITH DEALERS

INVESTMENT REQUIRED AND TENURE PROVIDED

The main factor which differentiates car Dealers from other franchisees is the significant level of investment which is required to be undertaken. The facilities housing the Dealership are often state of the art and Manufacturers demand large buildings with very specific requirements on the materials to be used and even the furniture to be installed both in the retail display area and the service workshop. It is incredibly common that the OEM mandates which supplier the Dealer needs to source material from. These suppliers are often overseas-based companies selling products at significantly greater cost than a local supplier selling almost identical products.

The cost often does not end with the initial investment and Manufacturers constantly ask their Dealers to upgrade facilities or even move to new locations to build a new facility. The cost of building these facilities often runs into millions of dollars.[1,2,3] Furthermore, significant costs are committed to prescribed equipment, special tools, training and various other costs. This is before all the other costs such as wages, stock, marketing etc.

Dealers are willing to make these investments because they believe in their ability as entrepreneurs to make a return on this investment. The key to achieving a return is the ability to recover this investment over an appropriate term. It takes many years for Dealers to recover these investments and secure profits.

Dealer Agreements in Australia are relatively short, averaging around 5 years, but we are now seeing examples of even shorter-term agreements. This has become concerning as we have also seen increasing instances of Dealers not being offered the option of renewal by the Manufacturer.

In its New Car Retailing Industry Market Study of 2017, the ACCC recommended the consideration of a "required minimum term for Dealer Agreements with the objective of allowing Dealers a sufficient period in which to recoup capital investment". Unfortunately, this issue has not been considered by government.

The lack of tenure and the increasing use of agreements that span as little as one-year is the key underlying characteristic of the power imbalance. For a Dealer that is constantly facing the fear of being 'non-renewed' it is impossible to push back against unreasonable demands of an offshore Manufacturer.

Why would a Dealer sign a one-year agreement? The answer is often that a Dealer has invested significant capital over a long period of time into the brand. The Dealer feels an obligation to the business (particularly in the case of a family business), its employees and their customers.

The Oil Code, which was developed to overcome a power imbalance between big businesses and the smaller businesses they deal with, has a mandatory minimum term of five years, plus an option of a four-year renewal.

1 https://ef.com.au/holdenatefauto/, AUSTRALIA'S LARGEST HOLDEN DEALERSHIP NOW AT EF, by Essondon Fields, last checked on 12 August 2019
2 https://premium.goauto.com.au/star-Dealership-ready-to-open/, STAR DEALERSHIP READY TO OPEN, by Neil Dowling, GoAuto Newse, 2 May 2019
3 https://www.goauto.com.au/news/maserati/15-million-maserati-melbourne-Dealership-opens/2014-12-01/19027.html, News - Maserati $15 million Maserati Melbourne dealership opens, by Richard Berry, GoAuto.com.au, 1 Decemeber 2014

Section 3

We believe a 5-year minimum term is appropriate for our industry and would question the ethics and the motives of any Manufacturer not comfortable with providing a five-year agreement, given the investments Dealers are asked to make. For reference, in the US and the EU Dealer Agreements are generally perpetual.

In the absence of a minimum fixed term, the AADA has suggested that we implement regulations that include a specific requirement for Manufacturers to provide an explicit link between the investment they ask of their Dealers and the tenure granted. This would provide Dealers with the opportunity to recover their investments and make a profit.

TERMINATION AND COMPENSATION PRACTICES

Termination, while still used on occasion, is perceived by Manufacturers as contestable and potentially subject to legal proceedings. Instead, non-renewal has become the favoured approach for Manufacturers which want to end their commercial relationships with Dealers. This is why we are seeing more and more Manufacturers make use of shorter-term agreements – because it allows Manufacturers the flexibility to issue non-renewal notices at more regular intervals. For example, one Manufacturer which has publicly flagged that it will be changing its distribution model has put the entire network on a one-year agreement which it keeps rolling over until the Manufacturer is ready to issue non-renewal notices to the entire network.

There are numerous examples of occasions where non-renewal notices have been issued to long-standing Dealers who have exceeded performance targets set by the Manufacturer. Scratch beneath the surface and more often than not the non-renewed Dealer is being punished for pushing back on a requested facility upgrade or being too outspoken at Dealer Council meetings for example.

While the practice of non-renewal is a convenient solution for Manufacturers wanting to exit a Dealer, the action taken by GM this year offers another avenue for Manufacturers. In that case, GM breached each and every one of the agreements they had with their 185 Dealers by stating they would no longer supply cars as required under the terms of the agreement. Because of the weak dispute resolution processes available to Dealers under the Franchising Code and the untenable proposition of a prolonged and expensive court battle, there was no consequence for GM's termination of its Dealer network and the unfair compensation it offered upon termination. The AADA is very concerned that GM's approach may be emulated by other OEMs.

There are various examples of Manufacturers terminating or not renewing a Dealer Agreement and providing no or very little compensation. If Dealers are unable to sell their business on the open market without interference, they immediately lose all the goodwill built up over a period of time. Manufacturers argue that goodwill belongs to the franchisor, but we have seen numerous examples where Manufacturer-owned Dealerships have been sold with a large component of goodwill.

Non renewed Dealers are left with a bespoke facility that cannot be easily repurposed. They are left with significant liabilities such as leases and wages. Manufacturers are often not willing to discuss compensating Dealers for such liabilities and some Dealer Agreements specifically rule against the provision of any compensation to an exiting Dealer.

Dealers who are exiting the franchise are also often left with significant levels of stock in vehicles and parts. Some Manufacturers do the right thing and include clauses in their Dealer Agreements in which they agree to purchase back stock in the event of a non-renewal.

However, most agreements leave this discretion to the Manufacturer. By not requiring OEMs to buy back stock, there is a perverse incentive for some Manufacturers to load Dealers with stock and parts before a non-renewal notice is issued.

PERFORMANCE REQUIREMENTS

When you act as a Dealer for an automotive brand in Australia you are operating in one of the most competitive automotive markets in the world. Around 68 brands offer more than 380 models for sale in a relatively small market of around 1 million units annually (less than 1.5 per cent of global demand). Manufacturers compete fiercely for market share and this intense competition extends to their franchised new car Dealer networks.

The primary measurement of performance most automotive brands use are volume-based sales targets. These targets are frankly often unrealistic, and it is often said that if you were to add together the combined target from every OEM in Australia, the number would be around 2 million units per annum (for reference around 1 million cars a year are sold in Australia). The information and data which Manufacturers use to set sales targets is rarely shared with the Dealer and seldom are targets reviewed and adjusted after the fact. Such is the pressure to achieve these targets that Dealers are often expected to register cars even when they are not sold, as a registration still accounts for a sale in VFACTs – the system which measures car sales in Australia and calculates market share and is owned and operated by the Manufacturers association, FCAI. This can easily lead to a Dealer being overstocked.

Another tool Manufacturers use to measure the performance of their Dealers is the customer satisfaction index (CSI), which is essentially the survey customers fill out after buying or servicing a car. Dealers understand the need for OEMs to measure their customer service performance, but the methodology for these tests is often subjective.

For example, a customer may consider awarding a Dealer 8 out of 10 for good service, but this same score may be considered sub-standard by the Manufacturer. Furthermore, often these scores are unattainable due to circumstances beyond the Dealers control but very much influenced by the OEM. Not having the customers preferred vehicle in stock due to OEM's inability to source it from the overseas factory will influence the CSI rating. A vehicle with a known fault which is constantly returned to the Dealership for repair will likely influence a customer's CSI score.

Other requirements OEMs may impose on Dealers are minimum stocking requirements; parts and accessories sale or wholesale targets; demonstrator and loan car programs and facilities compliance audits to name a few.

Manufacturers link incentive payments to these performance measures, the achievement of which is often the difference between profit and loss. Failure to meet performance requirements can result in performance management and eventually termination or non-renewal.

BEHAVIOUR AROUND WARRANTY CLAIMS AND AUSTRALIAN CONSUMER LAW

The power imbalance that exists between franchised new car Dealers and Manufacturers, inclusive of Importers, Distributors and Agents, gives cause to warranty and Australian Consumer Law (ACL) consumer guarantee arrangements that lead to harmful consumer and Dealer outcomes. Not all franchisor OEMs employ such aggressive and unfair policies, but those who do place Dealers in a no-win situation which can result in Dealers losing their franchise and a leave a trail of frustrated and dissatisfied customers with unresolved ACL claims.

Under Section 274 of the Competition and Consumer Act (2010) there is a requirement by Manufactures to indemnify suppliers (Dealers) for consumer guarantee claims made under the ACL.

Despite this requirement, some Manufacturers, normally operating under the instruction of their overseas head offices, enforce their own warranty policies and procedures in this country, without regard to the laws of the Australia. This unconscionable conduct creates significant obstacles and cost imposts for Dealers seeking reimbursement for reasonable costs and charges incurred in honouring the statutory consumer law obligations of the Manufacturer.

Some warranty policies and procedures are extremely administratively burdensome, draconian and restrictive and if scrutinised, are likely to be found in breach of the ACL. This creates a situation in which Dealers are frequently left with no alternative other than to cover the cost of the repair, sublet work and parts themselves, for fear of losing the franchise and all they have invested in their business.

Dealers attending to consumer guarantee claims are in a very difficult position. They are obliged to respond to ACL consumer guarantee claims while having no certainty that they will be compensated for their time and materials. Some Dealer Agreements go so far as to stipulate that all customer complaints be reported to the Manufacturer, who may choose to intervene and instruct the Dealer on how to respond. In these circumstances, compliance with Manufacturer instructions by the Dealer is not optional and failure to do so can have dire consequences for the Dealer, despite the consumer guarantee obligations.

Most Dealer Agreements in Australia allow provision for warranty reimbursement based on agreed rates for labour and parts, which are significantly lower than commercial rates. Dealers agree to these conditions under sufferance as taken within the context of the entire agreement, they reasonably expect to be able to make up the shortfall in other parts of their business. This results in Dealers being barely able to break even on warranty repairs, even under ideal circumstances. Australian practice through the ACL and Competition and Consumer Act should seek to emulate statutory provisions like those in the US, where warranty and consumer guarantee work is reimbursed at normal retail rates. This covers the high costs incurred of employing technicians, warranty administration and complying with Manufacturer dictated diagnostic and repair functions.

Section 3

Manufacturers also retain the right to conduct warranty audits on Dealers. While this is understandable, in the case of some Manufacturers, the failure to adhere to complex warranty administration procedures can result in a “clawback” by the Manufacturer, who upon finding examples of non-compliance with their rules will, at their sole discretion, reverse legitimate payments made to a Dealer through warranty and consumer guarantee claims.

Further Dealer detriment and substantial financial loss occurs when certain Manufacturers employ an unconscionable and potentially unlawful audit process known as “extrapolation”. Under this audit method, Manufacturer warranty auditors, often from the head office or a contracted third party who has no regard for the ACL, will select a small representative batch of warranty claims and determine an error rate which they will then apply to claims across a nominated time period, which could be 24 months or longer. This normally results in clawbacks by the Manufacturer of tens or hundreds of thousands of dollars even though the errors identified might be for small administrative oversights or process conformance mistakes. This practice is patently egregious, grossly unfair on the Dealer and breaches the statutory ACL and Competition and Consumers Act (2010) requirement of Manufacturers to compensate Dealers for work completed.

FINDINGS OF THE ACCC NEW CAR RETAILING MARKET STUDY 2017

In its New Car Retailing Industry Market Study of 2017, a lengthy section is devoted to various concerns identified by the ACCC regarding Manufacturer's warranty policies and procedures.

Among them, the ACCC noted (Section 3.4.3):

- *Rejecting claims by Dealers for reimbursement for consumer repair that are submitted outside of the claim submission period – sometimes within 10 days from the repair date – without a right of appeal.*
- *Voiding a Dealer's entitlement to repair costs under warranty or goodwill in the event that a repair order does not contain a customer signature.*
- *Reversing a claim during an audit if it is found that 'white out' has been used in any part of the technician's story detailing the repair order.*
- *Preventing Dealers from making a claim for an incomplete or repeated repair or from submitting a second claim for any omissions.*

The ACCC analysis of the practice of warranty extrapolation led to the ACCC concluding:

"Warranty policies that permit extrapolation on warranty audits and enable a Manufacturer to charge back to the Dealer excessive amounts have the potential to be unfair contract terms, given the potential for the extrapolation process to result in a significant imbalance and detriment to a Dealer and the apparent lack of necessity to protect the legitimate interests of the Manufacturer."

ENFORCEABLE UNDERTAKINGS

Over the last three years, five different Manufacturers have been forced to provide Court Enforceable Undertakings to the ACCC following concerns raised by the regulator about their compliance with the Competition and Consumer Act 2010.

In each of these examples, it is the franchised Dealer who has had to deal with the consumer complaints and has represented the brand to customers on the front line. Dealers have no role in designing, engineering or building motor vehicles yet are responsible for upholding the reputations of the brand and their own businesses. For this privilege, Dealers spend millions of dollars in training, tools, equipment and the provision of loan cars and facilities. Unfair, unconscionable and unjust warranty policies issued by some Manufacturers are demonstrably weighted in favour of the franchisor and run contrary to the good faith provisions expected between Manufacturers and their Dealer franchisees.

For Dealers, redress in these matters is almost impossible under current legislation, with many Dealer Agreements containing clauses that explicitly state that the Dealer has no right of appeal on warranty decisions, unjust warranty claim adjudications or unconscionable prior approvals, even when it is an ACL Consumer Guarantee related obligation.

The ACCC explicitly states on its website that it does not work to resolve individual complaints, instead referring complainants to the state consumer protection agencies and industry ombudsmen or to seek independent legal advice.

The ACCC will however offer advice and guidance and use information supplied to identify areas of concern. As the regulator most responsible for ensuring competitive fairness and consumer protection, it is important that the ACCC have enough resources to be able to identify trends in unfair behaviour by franchisors and take the necessary action. In the franchised new car sector, without the involvement of a regulator, Dealers are left with the unfavourable option of taking legal action against a Manufacturer many times larger in size and who is almost guaranteed to then seek retribution in some way, ultimately by performance managing the Dealer out of the network or through termination or non-renewal of the Dealer Agreement.

UNFAIR TERMS IN CONTRACTS

The following clauses are taken from Dealer Agreements and are examples of clauses, taken across several franchises, which are commonly given to Dealers on a take it or leave it basis. Dealers have typically invested heavily in the brands they represent and therefore feel obliged to sign such agreements, despite the unfairness of the clauses in them, which further entrenches the power imbalance between franchisee and franchisor. In some industries, franchisees would be protected from clauses such as these through the unfair contracts legislation, however, most new car Dealers do not qualify as small business and are therefore not afforded those protections.

Some examples are as follows:

- U*nless expressly provided for by this Agreement, termination or non-renewal or no grant of any Further Term of this Agreement by the OEM, on the conditions set out within, of itself will not entitle the Dealer to any payment or compensation*
- *Unless expressly provided for by this Agreement, termination or non-renewal of this Agreement by the OEM of itself will not entitle the Franchisee to any payment or compensation.*
- *Subject to any rights a party may have against the other party accruing up to the date of termination of this Agreement and subject also to various clauses which survive the termination of this Agreement, both the OEM and the Dealer agree that neither of them shall be liable to the other for any loss or damage of any kind which may arise as a result of termination of this Agreement.*
- *Upon expiration or termination (for whatever reason) of this agreement all amounts owing from the Dealer to the OEM become immediately due and payable. The OEM may set off such amounts against any amounts payable by the OEM to the Dealer in accordance with the Manual. In this paragraph "Dealer" includes any Related Corporation of the Dealer...*
- *The OEM and its employees and representatives are authorised to enter any premises of the Dealer to carry out any necessary works to remove signs using or incorporating the Trade Marks or to repossess any New Vehicles, Parts or special tooling the title of which has not passed from the OEM to the Dealer. The Dealer must pay the OEM's costs of doing so. The OEM may set off any such costs against any amount otherwise owed by the OEM to the Dealer.*
- *The Dealer acknowledges and agrees that at the end of the Dealership, the Dealer will not receive any payment or compensation from the OEM for any goodwill in connection with the Dealership or any reputation developed by the Dealer in connection with the Dealership or the Premises.*
- *The Manufacturer has the right to alter the size and extent of the territory or appoint additional Dealers in the territory from time to time by giving the Dealer one (1) months written notice of the change.*

Section 3

- *The appointment is not exclusive. The OEM may appoint other Dealers. The OEM may also supply Products directly to customers who request direct supply arrangements. Unless prevented by any obligation of confidence, the OEM will notify the Dealer Council of the existence (but not the particular terms) of any arrangements the OEM enters into for the direct supply of Products.*
- *The Dealer must not, directly or indirectly (including through a Related Corporation of the Dealer) agree, undertake, commit, accept any appointment concerning or conduct any business that involves the promotion, sale or servicing of motor vehicles or motor vehicle parts, accessories or other components other than the OEM Dealership Business.*
- *The OEM may apply changes to the allocated territory at its sole discretion and without the Dealer's consent upon expiry or termination of the Agreement.*
- *If the OEM decides that an additional Dealer may be required in the territory, it will advise the Dealer in writing and give the Dealer 6 months to present information relevant to the matter before The OEM makes its final decision. In presenting information to the OEM, the Dealer may submit a revised Business Plan setting out how it could represent the territory and its additional requirements in lieu of the additional Dealer.*
- *The final decision of whether or not to appoint an additional Dealer will be made by the OEM based on its business judgment which will include an assessment of the impact of the appointment, and the impact of not making the appointment, on the OEM Dealership Business and will include any market data that is not confidential. Where the OEM decides to appoint an additional Dealer, who will be located in the allocated territory, the OEM will notify the Dealer of the appointment and, subject to clause (XX), any resulting changes in the territory. Nothing in this agreement will be construed as requiring the Dealer's consent to the appointment of any additional Dealer.*
- *The Dealer must provide nominated service bays at the level prescribed within the Particular Terms. The nominated service bays shall be used solely to meet the Dealer's obligations under this agreement and for no other purpose.*
- *The Dealer acknowledges that: (a) neither the OEM nor any of its Personnel in any way guarantees that the Dealer will obtain any return on any investment of capital or loan funds provided by the Dealer to establish and operate the Dealership or that any part of the investment will be recovered by the Dealer.*

GOODWILL AND DATA OWNERSHIP

Dealers create goodwill by putting many years of hard work and investment into building up their business. It is the Dealer that makes significant investments and takes the lion's share of the risk and is rewarded by realising goodwill in their business. The fact that this goodwill exists is evidenced in the many transactions that involve the sale of Dealerships.

The goodwill in a Dealership can be immediately diminished to nil in the event of a non-renewal process or a termination. While non-renewals and terminations are inevitable, AADA would contend that a Dealer should, where appropriate, be compensated for all of the goodwill built up in the business.

The Government has committed to increase disclosure of end-of-term arrangements for goodwill. In particular, it will require franchisors to clarify a franchisee's entitlement to goodwill in the franchise agreement. It should be noted that many Dealer agreements specifically state that the Manufacturer retains ownership of the goodwill attaching to the brand.

The fear of non-renewal and the associated immediate loss of goodwill in a business merely increases the Dealers reluctance to push back against unreasonable demands from a Manufacturer. Unscrupulous Manufacturers understand this and use it to their advantage.

Similarly, some Manufacturers do not acknowledge that customer data is owned by Dealers. AADA is concerned that there is a growing trend of Manufacturers encroaching on the Dealer's customer data. While some information is shared for very specific reasons, such as safety recalls, it seems as there is a growing desire for OEMs to own this data which is very valuable. Once again, under the current circumstances where so many Dealers feel like they cannot push back against unreasonable demands of OEMs, there is a strong risk that customer data will be handed over under duress. One Manufacturer recently changed its distribution model and terminated dozens of Dealers in the process. During compensation negotiations with the exited Dealers a condition of compensation was that the Dealers hand over their customer databases, despite this being outside of the scope of the agreement which had been breached and was the subject of compensation negotiations.

Section 4

EXISTING LEGISLATIVE, REGULATORY & SELF-REGULATORY ARRANGEMENTS

FRANCHISING CODE OF CONDUCT

Relations between Dealers and OEMs are regulated by the Franchising Code of Conduct. The experiences of franchised new car Dealers under the Code has been very disappointing and is widely considered to have failed in addressing the power imbalance that exists between Australian car Dealers and the multinational car Manufacturers to which they are franchised.

The Code articulates disclosure requirements from franchisors (which are easily overcome by OEMs as expenditure is demanded for each new agreement, with agreement terms becoming shorter, allowing more regular demands for expenditure).

The Code also specifies minimum requirements in the event of termination or non-renewal, however, it still allows for no fault termination. The Code also establishes a process for dispute resolution, but there are no examples of Dealers making use of the dispute resolution under the Code to achieve a satisfactory outcome.

There is a requirement to act in good faith under the Code, but good faith is far from specific and the Code specifies that this obligation does not prevent a party from acting in their legitimate commercial interests.

AADA has long called for protections separate to Franchising Code due to the many unique features in our industry. The Code is more suited to traditional franchising businesses such as take away and restaurants rather than an automotive Dealerships, which are complex businesses which require large investments.

AMENDMENTS TO THE CODE FOR NEW VEHICLE DEALERSHIP AGREEMENT

On 1 June 2020, the Government amended the Franchising Code of Conduct by including Part 5 to the regulation which deals exclusively with new vehicle Dealership agreements. In general terms, the new regulations comprise the following elements, including AADA commentary on each element:

- **End of term obligations for both OEM and Dealer.**
  OEMs and Dealers are now required to provide a reason when they do not renew an agreement. They are also required to provide 12-months' notice if they intend not to renew an agreement. Unfortunately, the regulations allow the 12-month requirement to be waived if the agreement is for a period of less than 12-months, in which case the notice period is six months. It also reduces the notice period to one month if the agreement is six months or less. There is a real risk that this element of the regulations will result in OEMs offering shorter terms so that they can provide the shortest notice period possible.

- **Obligation to manage winding down of agreement in the event of non-renewal**.
  The AADA is concerned that the requirements for the franchisor and franchisee to agree to a 'winding down plan' can be easily frustrated by the franchisor deploying obstructive or delaying tactics to 'run down the clock' in the period leading up to the expiration of a Dealership Agreement. It remains unclear what leverage can be applied to parties of a Dealership Agreement that seek to frustrate the intent of these regulations.

  A major concern for Dealers is that the requirement to develop an agreement to reduce stock will encourage those Manufacturers that do commit to buying back stock in their Dealer Agreements to revert to the less stringent requirement contained in these draft regulations.

- **Limits on unreasonable capital expenditure by OEM.**
  We consider the way that the regulations have been drafted to be a less- than-perfect approach. While the suggestion that franchisor and franchisee need to discuss how the expenses would be recouped is welcome, we would contend that a mandatory linkage between the level of demanded capital expenditure and the term offered for the new Dealership Agreement is a superior approach, and one that can be coupled with easily understood, industry standard calculations to ensure that the new car Dealer has a realistic opportunity to recoup the expected capital expenditure. Similarly, the regulations require "discussions about under what circumstances the Dealer is likely to recoup the costs of their investment". Once again, AADA is supportive of the principle that Dealership Agreements should enable Dealers to recoup the costs of any capital expenditure. However, we would submit that the regulations need to go much further. In our view, any significant capital expenditure needs to be the subject of formal agreement by both parties, much like the end of term plan.

Section 4

- **Right to request multi-franchise dispute resolution.**
  The AADA supports the principle of allowing multiple franchisees that have similar disputes with their franchisor to seek to resolve the dispute through one common dispute resolution process. However, we note that the regulations contain no obligation for the franchisor to accede to the franchisees' request. In essence this proposal simply formalises what is currently in place and we hear many reports of Dealers requesting multi-party dispute resolution only to be denied by the Manufacturer.

Section 5

CURRENT AND PROPOSED GOVERNMENT POLICY

When the Government tabled the New Vehicle Dealership Agreement regulations on 1 June 2020, it acknowledged that further work was required by announcing that it would be progressing work on the issue of tenure and a principles-based compensation guide. This work is now underway. AADA is of the firm view that there needs to be a strong set of mandatory regulations which ensure adequate compensation and security of tenure.

Section 6

DISPUTE RESOLUTION SYSTEMS & PENALTIES FOR BREACHES OF THE FRANCHISING CODE OF CONDUCT

One of the biggest failings of the Franchising Code of Conduct is the weakness of the dispute resolution process. The Code is meant to address a power imbalance between franchisors and franchisees, but it fails when these relationships break down and franchisees are in need of a cost-effective, timely and determinative outcome. The Code affords parties to a franchise agreement to resolve disputes through mediation or legal action through the court system.

Successful mediation relies on both sides coming to the table and working towards a fair resolution. From experience, car Manufacturers are not inclined to negotiate, particularly, when the local management is acting on instructions from the offshore head office. When mediation fails, the only option for franchisees is to either comply with the franchisor's terms or to seek redress through the court system.

Taking on a car Manufacturer in the courts is a grim proposition even for a well-resourced Dealer. OEMs have large internal legal departments and their resources allow them access the best legal representation money can buy. A court challenge can take years at great financial cost, a point OEMs have often made to Dealers considering such action. OEMs are only too well aware of the reluctance of Dealers to challenge them through the courts and as a result there is very little incentive for them to engage in good faith mediation.

The limits of dispute resolution were laid bare in the dispute between GM Holden and its Dealers when after mediation failed, the Minister for Small Business, Michaelia Cash, wrote to both parties requesting they agree to settle their dispute via arbitration. While the Dealers agreed to participate GM bluntly refused, calling the Minister's request inappropriate and unhelpful.

Recently, the Government announced it would be strengthening the Franchising Code, by allowing for multi-party mediation, conciliation and voluntary binding arbitration. The AADA is disappointed that binding arbitration will be voluntary as that is essentially the system which exists today – a system so successfully avoided by GM.

There have been suggestions that there are constitutional problems with mandatory binding arbitration. However no detail of this limitation has been provided and we note that the Government has managed to introduce it in a number of other industry codes where there is a power imbalance. We believe if the will was there, a way could be found.

The penalties for breaches of the Franchising Code of Conduct have never been fit for purpose for multinational car Manufacturers. Even, the Government's recent proposal to increase penalties to just over $130,000 for a breach will do little to deter bad behaviour by automotive Manufacturers. General Motors for example is a $200 billion revenue a year company and will not be deterred by a fine of this magnitude.

Section 7

CURRENT & PROPOSED BUSINESS MODELS IN SELLING VEHICLES

The primary distribution model for selling vehicles in Australia is the traditional franchise model whereby Dealers who enter into a franchise agreement with OEMs are given the exclusive right to market and sell new vehicles and associated services within a specific geographic location. Dealers purchase vehicles and parts stock from the Manufacturer and then sell to the buying public in what is a traditional retail model, although franchisors exercise significant control of the Dealers business operations. The price of being a franchised new car Dealer is meeting significant investment demands, complying with brand standards and achieving strict performance targets.

There are variations of this model and there are instances of Manufacturers cutting out the Dealer and selling direct. Tesla does not have a Dealer network and sells its vehicles direct to the public. There are also a number of Manufacturers in Australia which have company-owned stores and (unlike Tesla) they compete directly with their Dealers, although it is unclear if they are subject to the same performance requirements.

Manufacturers have a long history of experimenting with alternative distribution models, but invariably the traditional franchise model has remained. However, currently a number of Manufacturers in Australia are pursuing a new distribution model known as an agency model. Under an agency arrangement a Dealer ceases to be the owner of the vehicle stock and instead is given a fee for service. Vehicles are sold at a non-negotiable fixed price. This is a key change because it limits the Dealers ability to use their entrepreneurial skills to compete and maximise profits.

It also means that Dealers no longer hold the stock at traditional levels and as a result there is a strong risk that they will be stuck with large expensive facilities which are no longer fit for purpose. OEMs have the right to shift to new distribution models. However, when this shift occurs Dealers should be adequately compensated to account for the reduced earning capacity and the significant investments they have made.

Mercedes-Benz has said it will be changing its distribution model in Australia to an agency model in 2022 and will not be compensating its Dealers. Recently one of their global executives told the media that they would be moving to this model in Australia because the law allowed for it, whereas other markets such as the US does not.

Section 8

LEGISLATIVE, REGULATORY & SELF-REGULATORY ARRANGEMENTS FOUND IN INTERNATIONAL MARKETS

UNITED STATES

The model often cited as best practice for regulating OEM/Dealer relations is in the United States, where every state in the union has recognised the power imbalance and developed automotive-specific franchising laws which regulate Manufacturer/Dealer relations.[4] While there are slight differences between the various state laws, they generally cover the following elements:

- Prevent Dealership terminations or non-renewal except for "good cause."
- In the event of termination, the laws specify the kind of compensation required.
- Upon non-renewal buy back of vehicles, parts, accessories, special tools and equipment.
- Relevant Market Areas (RMAs) grant a Dealer or group of Dealers' exclusive territorial rights by preventing the Manufacturer from establishing additional Dealerships within a given geographical area.
- Outlaws price discrimination by OEMs to Dealers.
- Make it illegal for OEMs to force Dealers to take vehicles they have not ordered.
- Stipulates payment required for parts and labor associated with warranty.
- Restrict Manufacturers from selling directly to the public.
- A process for resolving disputes which often includes determination or binding arbitration.

EUROPEAN UNION

EU regulations enacted in 2002, specified that in order to benefit from competition law exemptions, Dealer Agreements needed to either be open ended/perpetual or provide for a minimum of five years. The AADA understands that the overwhelming majority of Manufacturers continue to provide their Dealers with perpetual non-fixed term agreements. Generally, Manufacturers are required to provide a notice period of two years when they intend to end a Dealer Agreement.

It should be noted that there have been occasions where national laws have overridden the EU regulations and Dealers have successfully won damages against Manufacturers by relying on national laws.

The 2002 regulations expired in 2010, however, the Manufacturers under their industry association, the European Automobile Manufacturers Association (ACEA) have adopted a code of good practice in which they commit to maintaining provisions regarding these matters in their agreements with their authorised distributors and repairers. These include a minimum notice period of two years for regular termination of agreements of indefinite duration and the possible recourse to an arbitrator or independent expert for the resolution of contractual disputes.

4 See examples:
California: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB179
Maryland: http://www.mdautodealerlaw.com/dealer-franchise-laws.html
Illinois: http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2382&ChapterID=67
Virginia: https://vada.com/dealer-resources/vada-law-book/
Michigan: http://www.paulruschmann.com/about/mi_auto_franchise.pdf

CANADA

In Canada, automotive franchising relations are captured by generic franchising laws which apply at the provincial level. These laws impose a duty of fair dealing on each party to the agreement. In 2007, the automotive industry established its own dispute resolution process, the National Automobile Dealer Arbitration Program (NADAP).

Disputes are initially addressed using the Manufacturer's own dispute-resolution process and if unsuccessful, the process then moves into mediation through NADAP and if need be into arbitration. Since its inception, some 70 per cent of disputes have reportedly been resolved in a timely fashion and at minimal cost. There is a list of issues which can be brought before NADAP.[5]

5 National Automobile Dealer Arbitration Program (NADAP), http://www.cvma.ca/programs/nadap/, last checked 6 November 2020

Section 9

THE IMPOSITION OF RESTRAINTS OF TRADE ON CAR DEALERS FROM CAR MANUFACTURERS

Franchised new car Dealers are often required to comply with trading arrangements determined by the OEM, which are not favourable to the Dealer. Often these arrangements are not enforced by the prohibition of specific trading activities but are promulgated indirectly through the setting of eligibility criteria which if not complied with, result in Dealers foregoing significant rebates, without which they cannot operate profitably.

Manufacturers use clauses such as the following to retain the rights to withhold funds if the terms and targets they impose are not met:

> *The OEM may disallow (after audit or otherwise) any claims for or payments of compensation or allowances to the Dealer that fail to meet the OEM's requirements, policies and procedures as set out in the Manual or this agreement. The OEM will notify the Dealer within a reasonable timeframe of its decision to disallow any payment and give the Dealer an opportunity to explain why the payment should not be disallowed. If the Dealer fails to provide an explanation to the OEM's satisfaction within a reasonable time or the OEM declines to accept the explanation provided by the Dealer, the disallowed payment becomes a debt immediately due and payable by the Dealer to the OEM.*

The following are taken from real world examples of trading restrictions placed on Dealers by OEM's, using clauses like the one above to achieve their objectives:

- The tools and equipment used by a Dealer in the workshop are often readily available from local aftermarket suppliers for prices far lower than those supplied through the OEM or OEM affiliated supplier. Dealers however are not given the option to purchase from the supplier of their choice as it is frequently a requirement of the Dealer Agreement or its associated operations manual, that Dealers will only purchase through the OEM or OEM approved supplier. In the event that a Dealer is non-renewed or terminated, even after many years in operation, it is not unusual to find thousands of dollars' worth of special tools unused and still in their original packaging, sitting in workshop storage.

- An OEM strikes a deal with a lubricants supplier to provide products to its Dealer network workshops. Dealers are not directly forced into buying from this supplier, but sales targets are introduced for the oil and if Dealers do not achieve these targets then they forego eligibility for certain incentive payments in other parts of the business. They may also be subject to other punitive behaviour like warranty audits or unachievable sales targets. Dealers are not privy to the financial arrangements of supply deals like these or what the financial benefit is to the OEM, though there is most assuredly a rebate occurring to the OEM from the oil company.

Section 9

- A Dealer is requested to perform a facility upgrade at the request of the OEM and commences plans to do so. The OEM provides guidance on the corporate identity and the Dealer obtains an architectural design that is agreed to by both parties. The OEM then stipulates a bill of materials for the build that must come only from suppliers approved by them. The Dealer can source identical materials from a local supplier at much cheaper prices but is prevented from doing so by the OEM. The Dealer has no choice but to comply or risk losing the Dealership and the franchise in which he has invested many millions of dollars over many years.

- A new model of a popular ute is released but the OEM still retains significant stock of the outgoing model in its holding facilities. Dealers are informed via sales bulletin that they can only receive shipments of the new model if they purchase and report as sold, significant volumes of the old model. Dealers are aware that the outgoing model is outdated and holds little consumer appeal, meaning that it will most likely have to be retailed at rates below those of the wholesale price they have paid. Alternatively, Dealers can register the vehicle, report it as sold and sell it for a loss as a used vehicle. Doing so creates a distortion in the new vehicle sales figures which benefits the OEM. Irrespective of which option the Dealer chooses, he or she is forced into accepting a considerable loss just to earn the right to sell the new model.

One of the most significant restrictions Dealers face is taking on other franchises. At huge costs to their businesses, those Dealers wishing to do so have to establish totally separate operations, even in parts of the business that are not customer facing. As an example, this may mean that technicians and work bays in the workshop for a particular brand sit idle while other workshop resources are working beyond capacity, creating a backlog of work and delays for customers.

Clauses in Dealer Agreements, such as the one following, provide no guarantee that a Dealer will be able to take on another franchise, even if they agree to create totally separate workshop and showroom facilities, with dedicated staff. The ultimate decision and all discretion remains with the OEM and Dealers are given no right of appeal.

Section 9

NO MULTIPLE FRANCHISE WITHOUT APPROVAL

The Dealer must not, directly or indirectly (including through a Related Corporation of the Dealer) agree, undertake, commit, accept any appointment concerning or conduct any business that involves the promotion, sale or servicing of motor vehicles or motor vehicle parts, accessories or other components other than the (name of franchise) Dealership Business:

a. *at or from the Dealership Premises; or*

b. *that will, or is likely to, leverage or make use of any (name of franchise) trading name or involve personnel, facilities, resources, equipment or systems engaged, used or applied in connection with the conduct and operation of the (name of franchise) Dealership Business that has the effect of diminishing the operations of the (name of franchise) Dealership Business;*

without first obtaining the franchisors prior written approval in accordance with the procedures set out in the Manual.

This is just one further example of the power imbalance that exists between Dealer and OEM. For a Dealer who needs additional business to survive, restrictions like these create huge impediments to their business. Those Dealers who have invested heavily in people and facilities to serve a brand feel obliged to renew agreements and comply with trading terms like those demonstrated above. Not doing so puts them and the livelihoods of their employees at risk and the OEMs are well aware that in these circumstances they retain considerable leverage against the Dealer.

Section 10

CONCLUSION

We would be happy to meet with departmental staff to further discuss the submission above. If you have any questions, please contact me at the following:

James Voortman
Chief Executive Officer

CANBERRA OFFICE
Level 3, 10 National Circuit, Barton ACT 2600
PO Box 4409 Kingston ACT 2604

aada.asn.au