
FCAI Submission to Parliamentary Committee on the operation and effectiveness of the Franchising Code of Conduct



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EXECUTIVE SUMMARY

1. This submission is made by the Federal Chamber of Automotive Industries (**FCAI**), on behalf of itself and its members who distribute passenger motor vehicles, light commercial vehicles and SUVs (new motor vehicles), in response to the Parliamentary Joint Committee's inquiry into the operation and effectiveness of the Franchising Code of Conduct (**Code**).
2. The FCAI is the peak industry body for the automotive industry in Australia. Its members include all of the major importers of new vehicles in Australia (**Distributors**).
3. Unlike other franchise models, within the automotive sector there are a number of unique aspects to the relationship between a Distributor and a dealer, which means that it is not a "true" franchise. Motor vehicles dealerships are however included within the definitions of what constitutes a franchise in section 5(2) of the Code. Distributors have accepted the applicability of the Code and have incorporated the requirements outlined in the Code, into their contractual dealings and day to day operations.
4. Whilst the Oil Code of Conduct (**Oil Code**) is not directly relevant to the automotive industry, we acknowledge the similarities between it and the Franchising Code of Conduct; in particular, both codes aim to assist participants to make informed decisions when entering, renewing, or extending dealer/fuel-reselling agreements, amongst other things.
5. Given the complex nature of the relationship between Distributors and dealers, the current legislative framework and the enhanced powers of the ACCC effectively protect the interests of the participants in the automotive industry.
6. The ACCC's newly released market study, into the new car retailing industry, identified the sector as a "significant sector of the Australian economy" not only due to the fact that there are 3500 retail outlets, but that the revenue generated by car dealers in 2016-2017 was estimated to be \$64 billion¹. Any proposed changes to the operation and effectiveness of the Code must also bear in mind the multi-dimensional economic impacts, which may be likely to result.
7. It is also important to note that over the past five years the minimum term applicable to new motor vehicle dealerships have increased to a point where nearly all agreements are for a minimum of five years often with options to renew for a further five. Coupled with a sensible approach to maintenance of the brand image through capital investment, potential dealers have a significant period of time across which to assess the legal and financial opportunities available through the prospective dealership arrangements and make an informed decision on whether or not to agree.

¹ ACCC, "New Car Retailing Industry – A market study by the ACCC", December 2017, page 1.

8. The ability of the Distributor to manage the overall brand footprint in the market is a key to the health of all dealerships and the brand more broadly. From time to time, and with the increasing competitiveness of the Australian market, the network of dealers may need to be adjusted to take into account these changing market conditions. This is not only entirely appropriate, it is necessary to ensure maximum potential for overall profitability of the brand and the dealer network. The FCAI fully supports efforts to ensure that the franchise system is fair and balanced but does not support initiatives that seek to remove brand development and network management rights from the Distributor.
9. Overall the FCAI view is that the Code is currently more than adequate to handle the challenges that may arise from time to time across a very diverse set of businesses. To highlight instances of franchisee failures (whether financially or in terms of compliance with workplace laws) is not a reason to demand amendment to the Code. However, it is a reason to demand enforcement of the law as it is written.
10. If the operation of the Code on automotive dealers and Distributors is to be reviewed it would be more appropriate to do so as part of the next proposed review in 2020, as recommended by the Wein Review.

THE DISTRIBUTOR / DEALER RELATIONSHIP

1. In the automotive industry the relationship between a Distributor and its authorised dealers is not a “true” franchisor / franchisee relationship. This is primarily because, unlike “true” franchise systems, dealers in the automotive industry are not required to pay to the Distributor any upfront or ongoing franchise fees. Dealers do not pay an upfront fee to be appointed as a dealer, for the right to use a Distributor’s intellectual property, or for access to the substantial goodwill in the Distributor’s brand.
2. The fact that the automotive industry is not a “true” franchise is recognised in the Code itself. The general definition of “franchise agreement”² in the Code (which sets out the 4 indicia of a “franchise agreement”) does not apply to the automotive industry. It is only because a “motor vehicle dealership agreement” is expressly deemed to be a franchise agreement³ that the Code applies.
3. The reality is that the franchise model in its application to the automotive sector, is more akin to a distribution model, rather than a “pure” franchise.

² As set out in clause 5(1)

³ By clause 5(2)(c)

4. There are also a number of aspects of the relationship between dealers and Distributors that are unique. These include the following:

Distributors have a different level of control over dealers, compared to a pure franchisor/franchisee relationship.

- a. In most franchises, the franchisor has a significant degree of control over the operations of their franchisees, with all aspects of their operations prescribed (goods, services, processes, systems, staffing levels and the like) and identical from site to site. This is however, not the case in the automotive industry. Distributors have limited control over the operation of their dealers. They have very little, if any, visibility of the “back office” functions of the dealers and, by and large, dealers alone determine how to operate their dealership, which in most cases is multi-franchised (representation of multiple automotive brands).

Dealers are often large and sophisticated

- b. Prospective dealers in the automotive industry do not fit the stereotype of the “mum and dad” franchisee/investor, starting a business for the first time, selling a single product or service. On the contrary, most dealers are operated by experienced commercially minded people and many are large, multi-franchised corporations. For example, AHG Limited, one of the largest dealer groups in Australia is ASX listed, has annual revenue of about \$3.7 billion and employs approximately 7,500 people. As such, it is bigger than many of the Distributors with which it engages.
- c. Whilst not all dealers are ASX listed companies, even smaller regional and rural dealers are financially and commercially sophisticated on the basis that they are also often multi-franchise entities selling new vehicles, used vehicles and financial and insurance products, and manage a good number of multi-disciplinary employees, from automotive technicians, to financial controllers and business managers.
- d. As a result, the power imbalance between Distributor and dealer that may be present in other franchise models, is not a pronounced factor in the context of the automotive industry; in fact, the balance of power at times falls in favour of dealers.

Dealers often own key real estate

- a. Unlike in other franchise models, dealers (or entities with whom they are associated) often own the sites from which the dealerships operate. In metropolitan and regional areas, dealerships are often concentrated in key strategic locations, the land holding is extremely valuable and highly sought after for various uses.
- b. Unlike other franchise models, Distributors often have no step-in property rights or even rights of first refusal in relation to the sites from which the dealerships operate. In the event that the dealer is terminated, the dealer agreement is not renewed, or

the dealer wishes to surrender the dealer agreement, the Distributor loses a key strategic location which may heavily impact on the success of the brand in a geographic location. This power balance between dealers and Distributors cannot be overlooked.

The relationship is symbiotic

- a. Dealers and Distributors need each other equally; without a Distributor, a dealer does not have access to vehicles or parts and without a dealer, the Distributor may not have access to key strategic locations from which its products can be showcased and/or serviced.
- b. A strategically placed, well-established and multi-franchised dealer can have a substantial degree of power; if it were to cease being a dealer or did not wish to renew a dealer agreement with a Distributor, then the Distributor would suffer a significant loss in that market from which it could take many years to recover. It is also evident that where a Dealership agreement is not renewed at a particular site the Dealership more often than not quickly establishes a new brand, through a relationship with another Distributor, on that same site.
- c. Distributors recognise that the relationship between Distributor and dealer is symbiotic and engage with their dealers accordingly.
- d. Distributors work closely with dealer advisory councils, and discuss with matters of key strategic importance, realising that their success is dependent on the buy-in of their dealers. Generally, the dealer advisory councils are comprised of long standing and very experienced dealers, which creates a strong and highly engaged sounding board for Distributors.

FCAI RESPONSE TO MATTERS REFERRED TO JOINT PARLIAMENTARY COMMITTEE

(A) The operation and effectiveness of the Franchising Code of Conduct, including the disclosure document and information statement, and the Oil Code of Conduct, in ensuring full disclosure to potential franchisees of all information necessary to make a fully-informed decision when assessing whether to enter a franchise agreement.

The current disclosure regime is effective in terms of providing potential dealers with the information necessary to make an informed decision about entering into a dealer (franchise) agreement.

As a result of the disclosure and information statement obligations mandated by the Code, potential dealers are provided with a substantial amount of information by the Distributor. Potential dealers are also provided with a copy of the dealer (franchise) agreement. The prospective dealer then has 14 days to consider this information before entering into dealer agreement, or any associated agreement. At this point, the onus is ultimately on the prospective

dealer to read and process this information, and to obtain independent legal and financial advice before entering into the dealer agreement (see clause 10(2) of the Code) and to ask additional questions of the Distributor.

A potential dealer is not obliged, under any circumstances, to sign an agreement with the Distributor and as noted above, many established dealers have significant bargaining power.

Looking at the specific issues raised in the terms of reference, we make the following additional comments:

i. information on likely financial performance of a franchise and worse-case scenarios:

The Code has adequate provisions at clauses 17(1) (and clauses 20 and 21 of Annexure 1) requiring disclosure of financial details of the franchise by Distributors. Given the size and history of the Distributors operating in the Australian market, Distributors can and do provide as much information as they can to potential dealers to assist them in their decision to become a dealer.

In the automotive industry, it is extremely rare that an individual or entity would approach a Distributor as a prospective dealer without any prior knowledge or experience of the automotive industry, or without an understanding of the financial performance of the Distributor. On the contrary, potential dealers in the automotive industry often have a better idea of the issues facing the retail market because they invariably already have experience in the automotive market. Even if such information is not known, the fact that Distributors are required to provide the contact details for other dealers provides potential dealers with the opportunity to obtain such information.

Prospective dealers are also able at any time to request additional information from Distributors to support their decision-making processes and this frequently occurs. The information flow is not limited to prospective dealers, but often their representatives (legal and financial) contact Distributors should further clarification be required.

In addition, it is important to remember that a Distributor has limited control over the operations of their dealers. It is largely left to dealers as to how they run their businesses. Successful dealers are well run, dealers that fail are invariably not well run – which comes down to business management. In other words, the likely financial performance of a franchisee will depend much more on the performance of the franchisee itself than the actions of the franchisor.

ii. information on the contractual rights and obligations of all parties, including termination rights and geographical exclusivity,

Notwithstanding the fact that the Code currently requires disclosure about the contractual rights of all parties, dealers are also advised and encouraged to obtain legal and financial advice in relation to the terms of the dealer agreement proposed.

Since the introduction of the Code, dealership agreements in the automotive industry have been drafted with the Code in mind and as a result, contractual rights including termination, are aligned with the provisions contained in the Code.

Geographical non-exclusivity is a well understood concept within the automotive sector, in that Distributors generally do not allocate territories, but a local marketing area or prime marketing area (also known as a PMA) within which dealers should focus their marketing efforts. In fact, geographic exclusivity with time has become less relevant to the automotive industry for a number of reasons, including:

- customers have the freedom to obtain multiple quotations from different dealers (and do) and are free to purchase a vehicle from any dealership they wish, irrespective of what geographic boundary may apply to the dealership;
- dealers are increasingly using the Internet to advertise their dealership;
- most Distributors now measure a dealer's performance on total sales, not sales within a geographic area; and
- it is not in the interest of Distributors to have dealerships in close proximity as the market is generally not large enough to sustain a saturation of the same dealership type in close proximity.

iii. information on the leasing arrangements and any limitations of the franchisee's ability to enforce tenants' rights, and

A dealer's leasing arrangements and rights as a tenant are not a relevant consideration as Distributors do not typically control the sites of their authorised dealers, nor do they generally have step in rights. Further, as noted above, many dealers (or entities with whom they are associated) own the sites where their dealerships are located.

iv. information on the expected running costs, including cost of goods required to be purchased through prescribed suppliers;

An automotive dealership is a complex business and there are inherently many relevant variables. Notwithstanding this, the Code requires sufficient disclosure (at clause 14 of Annexure 1 to the Code) of expected running costs and prospective dealers, who are typically experienced in such operations, have a good understanding of what their likely costs might be.

It is common place for Distributors, like other franchisors, to have a panel or a supplier listing from which dealers may source goods and/or services relevant to the operation of the dealership. This fosters efficiencies (both in terms of fiscal and process) and safeguards the Distributor's intellectual property.

Distributor generally go to great lengths to ensure that the suppliers they engage with provide favourable terms, have an emphasis on quality assurance, product and service consistency, and have the capability to support the entire dealer network.

As Distributors are granted distributorships for Australia (amongst other regions), Distributors are generally responsible for the management of intellectual property within the region licenced to them. Consequently, Distributors are required to maintain

tight controls over which suppliers they will engage with, and a dilution of this control may compromise the value of their brand.

Goods or services which may be relevant in this context to the automotive sector may be signage, training support, point of sale displays and the like.

(B) The effectiveness of dispute resolution under the Franchising Code of Conduct and the Oil Code of Conduct;

The FCAI considers the dispute resolution processes under the Code to be effective, in that either party may initiate a formal mediation, without the need to issue legal proceedings. Whilst the process is generally effective, there is always room for improvement.

We are unable to provide meaningful comments on the effectiveness of the Oil Code dispute resolution process, as we are not familiar with the practical operation of that process. Importantly, in the case of the new motor vehicle distributors there is an established and regular pathway to discussion with dealers through the national dealer councils.

(C) The impact of the Australian consumer law unfair contract provisions on new, renewed and terminated franchise agreements entered into since 12 November 2016, including whether changes to standard franchise agreements have resulted;

The extension of the unfair contract provisions under the Australian Consumer Law (**ACL**) to small businesses has had no significant impact on the automotive industry, primarily because most dealers do not fall under the definition of a “small business”.

Having said that, even if the unfair contract provisions did apply, it is highly unlikely that any provisions of existing dealer agreements would be considered to be “unfair”, as prior to the appointment, the dealer has ample time to review and assess the terms of the dealer agreement, they are afforded an opportunity – and are encouraged - to seek legal advice and raise their concerns with the Distributor. Should the terms of the arrangement offered to prospective dealers not be appealing, the dealer is ultimately not compelled to sign the dealer agreement.

FCAI is strongly of the view that in the case of new motor vehicle dealerships they are business arrangements that are far removed from the original intent of the unfair contract term legislation, which was to protect those that do not have the wherewithal or opportunity to fully consider and appreciate proposed contract terms. This is not the case with new motor vehicle dealerships. Furthermore, dealer agreements are already subject to a number of similar legislative protections including:

- the Code – where a failure to act in good faith can attract a significant penalty;
- the unconscionable conduct provisions of the ACL– a breach of which also attracts a significant penalty;⁴ – and

⁴ Of up to \$1.1million for a corporation – s224 of the ACL

- in NSW, the *Motor Dealers and Repairers Act 2013*.

The introduction of any further protections to dealers must be properly balanced against the right of Distributors to manage their businesses and their dealer networks effectively. If a Distributor is prevented from being able to properly manage its dealer network as a whole, dealers will suffer. It is in dealers' collective commercial interests for the network to provide a high quality, consistent customer experience and for it to be strong and profitable. This might mean that from time to time a Distributor has to make a decision that might impact on one or a small number of dealers in the interests of the balance of the dealer network.

(D) whether the provisions of other mandatory industry codes of conduct, such as the Oil Code, contain advantages or disadvantages relevant to franchising relationships in comparison with terms of the Franchising Code of Conduct;

Yes, in our view, the Oil Code does provide some operational advantages to suppliers within that sector, one of which is described below.

(E) The adequacy and operation of termination provisions in the Franchising Code of Conduct and the Oil Code of Conduct;

In general terms, the termination provisions in the Franchising Code are adequate and operate effectively. That is, agreements can be terminated immediately in limited circumstances, such as for breach provided that the breaching party has been given a reasonable opportunity to rectify the breach and on reasonable notice in the circumstances as outlined in the Code.

Notwithstanding our view that the termination provisions contained in the Franchising Code are adequate, the Oil Code does contain operational advantages, specifically relating to special circumstances whereby a supplier is not required to provide a retailer (in the Oil Code context) with the right to remedy a breach before proceeding to a termination. Whilst most of the special circumstances mirror the Franchising Code, the Oil Code provides suppliers with the ability to terminate a fuel re-selling agreement on the basis that there has been a breach of a provision of the fuel re-selling agreement at least three times.

(F) the imposition of restraints of trade on former franchisees following the termination of a franchise agreement;

The imposition of restraints of trade on former franchisees is not a common practice amongst Distributors in the automotive industry.

(G) The enforcement of breaches of the Franchising Code of Conduct and the Oil Code of Conduct and other applicable laws, such as the *Competition and Consumer Act 2010*, and franchisors; and

The FCAI does not consider there to be any impediment to enforcement of the Code, or other applicable laws. The ACCC is adequately resourced and has all the necessary powers required to enforce the Code, as demonstrated recently by the investigation and enforcement action taken in regard to particular issues within the retail franchise system.