AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION LTD.
ACN: 167 598 085
Office 6, Level 4, Suite 12, 150 Albert Road, South Melbourne, Victoria, Australia 3205 | www.aada.asn.au

Supplementary Submission to the New Car Retail Market Study

The Power Imbalance Between Vehicle Manufacturers & New Motor Vehicle Dealers

1. There is a structural power imbalance between New Motor Vehicle Manufacturers (**Manufacturers**) on the one part and Retail New Motor Vehicle Dealers (**Dealers**) on the other. This imbalance disadvantages Dealers as it leaves them vulnerable to financial detriment having regard to the level of investment required in acquiring and running a new vehicle Dealership. This power imbalance also disadvantages consumers who purchase new vehicles from Dealers. This is because Manufacturers exert a high degree of control over how Dealers can deal with consumer complaints. This paper identifies the reasons for the structural imbalance, how the imbalance manifests itself and how the imbalance can mitigated.

Reasons for the Structural Imbalance

2. The structural imbalance between Manufacturers and Dealers exists because of the:
   (a) significant capital investment required by a Dealer to acquire and operate a new vehicle Dealership - often in the millions of dollars;
   (b) highly prescriptive nature of dealer agreements (which are recognised as franchise agreements under the *Competition and Consumer (Industry Codes - Franchising) Regulation 2014* (**Code**)). The dealer agreements seek to codify the standards for operation of every aspect of Dealers' new car retailing businesses and set aggressive sales targets in what is a highly competitive market;
   (c) lack of negotiation that occurs when entering into dealer agreements. It is always a 'take it or leave' it situation;
   (d) fact that Dealers can have their dealer agreements terminated for breach of a term of the dealer agreement or not remedying a breach of the dealer agreement within a prescribed time period;
   (e) lack of tenure in dealer agreements - having regard to the level of investment required to acquire and operate a new vehicle dealership; and
   (f) lack of protection afforded to Dealers by the Code.

How The Structural Imbalance Manifests Itself

No Security of Tenure

3. The tenure offered by Manufacturers for their dealer agreements has eroded over time. This means that, in relative terms, the investment demanded of Dealers by Manufacturers has increased while simultaneously the time given to Dealers to recoup their investment has been cut.

4. Tenure is not only short, but there is no security of tenure being extended - even though millions of dollars of upfront capital expenditure may be required of a Dealer. In particular:

(a) tenure, as an industry standard, is now only for a maximum of 5 years;

(b) Dealers are not always provided with a right of renewal; and

(c) where a right of renewal is offered, in most cases the renewal is at the absolute discretion of a Manufacturer.

5. The combination of short tenure and an absence of security of tenure is used by Manufacturers to put pressure on Dealers to refurbish or relocate dealerships. This, in turn, places Dealers under pressure to:

   (a) recoup their investment in a very short period of time (which may not be possible); and/or

   (b) accede to and obey the instructions of Manufacturers at every turn in order to maximise their prospects of renewal.

Non-Renewal

6. There is an increasing trend of Manufacturers issuing 'non-renewal notices' to Dealers who have met or exceeded their performance targets, are not in breach of the dealer agreement and who have incurred significant capital expenditure in the initial term of their dealer agreement.

7. Furthermore, unlike termination for breach, the Code does not compel a manufacturer to cite reasons for providing a non-renewal notice. Accordingly, non-renewal notices are often used by Manufacturers as a *de facto* means to exit a Dealer from their dealership rather than having to serve breach notice in accordance with the Code. This avoids the possibility of the Dealer remedying the breach and retaining their dealership.

8. Accordingly, any conduct by Dealers which runs contrary to the instructions or express wishes of Manufacturers (for example, in relation to a consumer complaint) risks the Dealer's entire investment in their dealership business.

9. Because the Code does not require a Manufacturer to provide reasons for issuing a non-renewal notice, it makes it difficult for a Dealer to assess whether the Manufacturer has exercised its right to issue a non-renewal notice in good faith.

Undisclosed Capital Expenditure Protections Do Not Work

10. Manufacturers routinely put pressure on Dealers to incur significant capital expenditure in the form of refurbishments, building new premises or relocating premises. . The Code is designed to provide safeguards to franchisees (Dealers) with respect to having to incur significant capital expenditure but these protections are easily avoided. In particular:

    (a) the threat of non-renewal is used by Manufacturers to force Dealers to incur additional capital expenditure within the term of their current dealer agreement in order to be ready for their 'new' agreement. This expenditure is not treated as requiring prior disclosure to Dealers when entering into their <u>initial</u> dealer agreement because Manufacturers take the position that the expenditure is for an entirely new agreement;

    (b) in their disclosure documents to Dealers issued pursuant to the Code, Manufacturers sometimes disclose extreme ranges of expenditure which ‘may’ be required during the

term of the agreement (e.g. $50,000 to $50,000,000). Such ranges provide no real guidance as to the true level of expenditure and hence the level of financial risk the Dealer will be incurring;

(c) Manufacturers can also compel Dealers to incur undisclosed capital expenditure during the term of the dealer agreement (despite the latest Code amendments seeking to safeguard against such practices) by:

(i) engaging in the conduct identified in sub-paragraph (a) above; or

(ii) amending their 'Franchise Standards' or 'Dealership Fitout' policies effectively requiring Dealers to refurbish or relocate; and

(iii) providing a written statement setting out the rationale for the expenditure, the benefits and risks of making the investment in accordance with clause 30(2)(e) of the Code. In practical terms, providing this 'written justification' is easy for Manufacturers and there is no mechanism for Dealers to challenge it.

End of Term Arrangements

11. There are a number of Manufacturers that do not mandate the buying back from Dealers of new vehicles, parts and special tooling once a dealer agreement expires or is terminated. In such cases, it is at the Manufacturer's discretion as to whether it exercises any 'buy back' rights from the Dealer. In some cases, Manufacturers also require Dealers to remove 'company signage' at the Dealer's expense. These situations create further financial hardship for Dealers once their dealer agreements have expired or terminated.

Consumer Complaints

12. In a number of instances, Manufacturers in their dealer agreements:

(a) require Dealers to adhere strictly to the Manufacturers' 'policy' regarding warranty or potential product defect claims (which policies can be unilaterally varied by the Manufacturers at any time);

(b) prohibit Dealers from making any admission of liability to a consumer in relation to a potential product defect without the prior approval of the Manufacturer;

(c) require Dealers to obey any instructions received from a Manufacturer in relation to a consumer's request, complaint, claim or legal proceeding in relation to a potential product defect;

(d) grant the Manufacturer the ability to assume total control of a Dealer's handling of a request, complaint, claim or legal proceeding in relation to a potential product defect (in some cases at the Dealer's cost); and

(e) state that Dealers will lose their right of indemnity against Manufacturers if the steps set out above are not adhered to.

13. Even if the terms of a particular dealer agreement are not as prescriptive as those set out in paragraph 12 above, Dealers still face commercial pressure to cede to and obey the wishes of

Manufacturers when it comes to any potential product defect, by reason of the significant imbalance of power described in this paper.

14. In addition, the statutory indemnity against Manufacturers available to Dealers under section 274 of the *Australian Consumer Law* is of very limited practical value as it can only be exercised if there is an actual *finding of liability* against a Manufacturer. This rarely occurs as most claims are settled before any 'finding of liability' by a Court or Tribunal of competent jurisdiction.

How The Imbalance May Be Mitigated

15. The Code was introduced in 1998 after the Federal Government concluded that:

    (a) there was a significant disparity of bargaining power between franchisors & franchisees;

    (b) key aspects of franchisor behaviour were detrimental to franchisees;

    (c) voluntary or 'self-regulation' was not working to curb these behaviours;

    (d) nothing would change without a mandatory industry Code.

16. It is apparent that, at least in relation to Dealers, the Code has failed to serve the purpose for which it was introduced.

17. The relationship between Manufacturers and Dealers differs from most other franchise relationships. The reasons for this include:

    (a) the significant capital expenditure that is required to acquire and operate a motor vehicle dealership;

    (b) the large number of employees employed by a Dealer;

    (c) the fact the all Manufacturers in Australia are subsidiaries of off shore based multi national companies;

    (d) the high degree of mechanical and technological sophistication of the products they sell;

    (e) the relatively high price of the products that are sold - from $15,000 to the hundreds of thousands;

    (f) the high degree of contractual, legislative and regulatory control imposed on Dealers;

    (g) there is an extended after sales relationship between a Dealer and its customers.

18. The Code does not adequately address the often unique circumstances faced by Dealers. Accordingly, an Industry Code of Conduct specifically designed for Dealers would go a long way in mitigating the imbalance of power between Manufactures and Dealers - and the resulting detriment to consumers.

19. A Dealer specific Industry Code ought to contain the following provisions:

    (a) The provisions of the present Code; and in addition

    (b) A minimum tenure of 5 years and one renewal period of 5 years;

    (c) Any right of renewal may only be exercisable by a Dealer (and not the Manufacturer) so long as the Dealer is not in breach of the dealer agreement;

(d) As an alternative to 18(c), a prohibition on Manufacturers issuing non-renewal notices to Dealers without a Manufacturer first issuing a written statement setting out why the Manufacturer has decided not to renew that Dealer, what steps the Dealer could take to address those reasons and what rights the Dealer has to challenge those reasons if the Dealer disagrees;

(e) A prohibition on Manufacturers imposing undisclosed capital expenditure during the term of a dealer agreement beyond a threshold amount (under any circumstances) - or otherwise a guarantee of a minimum extension of tenure in the event of significant capital expenditure being incurred within a term of a dealer agreement;

(f) A prohibition on Manufacturers disclosing significant capital expenditure in a disclosure document in the form of a range that that is not reasonably precise or confined;

(g) Mandatory end of term 'buy-back' arrangements;

(h) A prohibition on Manufacturers engaging in *unjust conduct* or entering into *unfair contract terms* as is the case in the *Motor Dealers & Repairers Act 2013* (NSW) (see sections 142 & 143);

(i) A prohibition on Manufacturers prescribing how a Dealer must respond to consumer requests, complaints, claims or legal proceedings in circumstances where Dealers have independent statutory obligations to consumers under, for example, the Australian Consumer Law; and

(j) More effective statutory indemnity provisions in favour of Dealers. In particular, the right of indemnity under section 274 of the *Australian Consumer Law* should not be restricted to only where there is a 'finding of liability'.

20. There is already precedence for industry specific codes for parties who would otherwise have been protected by the Code, namely the parties covered by the *Competition & Consumer (Industry Codes - Oil) Regulations 2017* (Cth).

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