AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

REFINEMENT OF REGULATORY REFORM: FRANCHISE RELATIONSHIPS BETWEEN CAR MANUFACTURERS AND NEW CAR DEALERS

SUBMISSION TO THE DEPARTMENT OF INDUSTRY, INNOVATION AND SCIENCE

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FOREWORD

AADA is pleased to respond to the Department of Industry Innovation and Science's request for comments on the *Refinement of regulatory reform: Franchise relationships between car Manufacturers and new car Dealers*. We welcome the opportunity to participate in this consultation process and urge the Government to give serious consideration to the points made in this submission.

Our favoured position remains a stand-alone mandatory Automotive Code of Conduct with a package of reform options broader to those offered in the RIS to date.

Under the revised RIS a number of the exit arrangement requirements proposed for Manufacturers under the original RIS have now been extended to Dealers. We welcome greater cooperation in the event of a Dealer Agreement ending, however it is the Manufacturer who grants the franchise, develops the terms of the Dealer Agreement and has the final say on whether a Dealer is to remain in the network at the end of the term. The purpose of these regulations should be to remedy the obvious power imbalance which currently exists in commercial relations between local Dealers and powerful offshore vehicle Manufacturers, not put additional obligations on Dealers.

The revised RIS requires parties to develop a plan to end the Dealer Agreement and manage down stock. The AADA is supportive of this principle, but such a process would need to be documented, transparent and auditable to ensure proper effort on behalf of both parties.

Similarly, the revised RIS would require "discussions about under what circumstances the Dealer is likely to recoup the costs of their investment". Once again, AADA is supportive of this principle, but would urge that the detail of the regulation requires Manufacturers to supply pre-determined information which will give the Dealer a clear indication of the likelihood of them recouping their investment and making a reasonable profit. Dealers are asked to invest significant amounts of capital and should be given a term which reflects this investment.

We have offered some insights into the regulatory costings for Options 2B (only one line, often a template to many Dealers), 2C, 2D (how is this different? All that needs to change is the figure which already needs to be disclosed needs to be more specific), 2E (now "new" terms would need to be drafted).

James Voortman
Chief Executive Officer

ANSWER TO QUESTION 1

Q1 - WHAT IS YOUR VIEW OF THE REVISED OPTIONS?

The AADA is broadly supportive of the refined RIS but are seriously concerned that the proposals fail to integrate the various elements that make for a successful relationship between automotive franchisor and franchisee into a coherent whole. We note the absence of any specific and mandated link between the length of tenure offered by the franchisor and the amount of capital expenditure asked of the franchisee. Similarly, the refined RIS fails to include any specific protection from Unfair Contract Terms (UCT) and does not include specific linkages to the ACL both for the level of penalties that breaches of the Code might incur, or in terms of indemnities by the franchisor for the franchisee when acting to satisfy consumer guarantee claims.

While it could be argued that some work on UCT and on indemnities are being worked on through other regulatory streams, it is still the case that the Automotive Code is an opportunity to bring all those elements into one coherent document that addresses the totality of the relationship between new car Dealers and the overseas vehicle Manufacturers.

OPTION 2A: 12-MONTH NOTICE PERIOD

Extend the obligation to provide 12 months' notice when not renewing an agreement to Dealers as well as Manufacturers.

AADA believes that requiring Dealers to provide the same notice period as OEMs is a flawed principle. We have no objection to the regulatory costs associated with the provision of such notice. However, the obligation under the current franchising code places the onus exclusively on the franchisor because it is the franchisor that grants the franchise, develops the terms of the Dealer Agreement, has exclusive control over the supply of the inventory and has the final say on whether a Dealer is to remain in the network at the end of the term.

In the case of the automotive industry, the Manufacturers can pull a number of levers or make business decisions at the stroke of a pen that can substantially change the nature of the business. Ever changing incentive programs, establishing new dealerships within the existing Dealers prime market area, the discontinuation of a popular selling model, the inability to sell a popular model due to a recall – these are all outcomes driven by the Manufacturer that can render a business unviable.

However, negotiations on renewals of agreements often start more than a year in advance and it is in the best interest of the Dealer to give as much notice as possible to facilitate an orderly exit from the network.

We thus support this recommendation with reservations.

Require parties to develop and agree to a plan to end the dealership agreement (including a requirement for the parties to work co-operatively to manage stock).

The AADA supports the principle of requiring parties to develop and agree to a plan to end the dealership agreement (including a requirement for the parties to work co-operatively to manage stock). We have a strong preference that the regulations include an obligation on OEMs to buy back the stock that they have sold to Dealers ahead of a decision to end the relationship with a Dealer, however we support a requirement to develop a plan that ends the dealership agreement. It is important that this plan is documented, transparent and auditable, and takes consideration of key issues such as goodwill and compensation; stock management, moneys from marketing funds, removal of signage, etc.

OPTION 2B: REASONS FOR NON-RENEWAL

Extend the obligation to provide a statement of reasons for non-renewal to Dealers as well as Manufacturers.

The AADA sees no problem in requiring Dealers that don't renew their Dealer Agreements to provide a reason.

OPTION 2C: STOCK BUY-BACKS

The AADA is disappointed that this measure remains unsupported in the revised RIS and urges the Government to rethink this and include it in the final regulations.

Dealership agreements typically require Dealers to maintain specified stockholding levels, not just for vehicles but also for parts. They also mandate the purchase and use of expensive brand-specific tools. We would argue strongly, that if the Franchisor requires the Franchisee to meet stockholding requirements, then there must be a requirement for the Franchisor to buy back that stock and those tools when the agreement comes to an end.

While we accept that discount pricing may be required to account for older parts for superseded models, the principle remains that to buy back stock, should not be left to the discretion or goodwill of the franchisor.

OPTION 2D: REQUIRING PRE-CONTRACTUAL DISCLOSURE OF SIGNIFICANT CAPITAL EXPENDITURE TO HAVE A GREATER DEGREE OF SPECIFICITY.

Extend the obligation to include discussions about under what circumstances the Dealer is likely to recoup the costs of their investment.

Anecdotal evidence shows that some Manufacturers have required Dealers to make investments that could not possibly be recouped over the course of the term of the dealership agreement. This places Dealers under immense pressure to secure a renewal of their term. Some Manufacturers exploit this weakness by placing unreasonable requirements on Dealers who in turn feel compelled to comply or risk non-renewal. That is why it is critical that these regulations include a linkage between the investments required and the tenure granted.

We thus support the revision to the RIS which requires an "obligation to include discussions about under what circumstances the Dealer is likely to recoup the costs of their investment". Put simply if the capital expenditure required by the Manufacturer is divided by Dealer's Nett Profit After Tax (NPAT), this will indicate the period required to recoup the investment. For example, if a Dealer with an NPAT of $650,000 is asked to invest $10 million, then the payback estimate is around 15 years. This sort of calculation is why franchisors such as McDonald's offer terms of 20 years, whereas new car Dealers face offers of sometimes no more than one year.

OPTION 2E: MINIMUM FIVE-YEAR CONTRACT PERIOD WITH RIGHT OF RENEWAL

AADA notes that this option remains unsupported and we are willing to forego demands for a standard fixed term in exchange for a formal linkage between capital investment required and tenure. See our position on Option 2D.

OPTION 2F: MULTI-FRANCHISEE DISPUTE RESOLUTION

AADA supports this reform option.

ANSWER TO QUESTION 2

Q2 - DO THE COST ESTIMATES REFLECT THE EXPENSES EXPECTED TO BE INCURRED BY INDUSTRY IN REVIEWING NEW DEALERSHIP AGREEMENTS? IF NOT, WHY?

OPTION 2A

The costings state it would take a lawyer two hours to draft a non-renewal notice each time an agreement is not renewed at a cost of $500 per hour. It should be noted that this non-renewal notice is an existing requirement under the current Franchising Code. The provision of a reason within the non-renewal notice is what should be costed. The simple exercise of adding a couple of lines or a paragraph to the letter that is already provided is highly unlikely to result in an additional two hours of work.

Furthermore, in recent years OEMs have issued non-renewal letters to a group of Dealers simultaneously, the most prominent example being the provision of a non-renewal notice to 30 Holden Dealers in 2017. In cases such as these, AADA has noted that letters to various Dealers within the network often have very similar content, suggesting that a template is used. We thus believe the regulatory costs of this option may be even lower than estimated by the revised RIS.

OPTION 2B

We believe the regulatory costs will be negligible. Support.

OPTION 2C

We believe there are flaws in the regulatory costs of this reform option. The revised RIS assumes that Manufacturers incur a regulatory cost when they are required to purchase back stock. However, the RIS does not recognise that that Dealers have already paid to purchase this stock from the Manufacturer. We believe the money received by the Manufacturer from the Dealer in the initial transactions should be accounted and will drastically reduce the cost in the revised RIS.

OPTION 2D

We concur that benefits would exceed costs; particularly as outlined costs are miniscule when compared with the impact on Dealers of requests for capital expenditure that have not been properly disclosed at the time of signing of the agreement.

OPTION 2E

We note that the RIS highting this option has a low regulatory burden. The issue of economic ramifications for Manufacturers should really be a consideration related to the capital expenditures they request of Dealers. The five-year term with one option of similar renewal is in practice much shorter than is regularly offered for fast food franchises where the level of capital expenditure is typically less than that of a car dealership.

ANSWER TO QUESTION 3

OPTION 2F

The RIS correctly notes that there would be no regulatory burden resulting from this change. It is worth noting that an effective multi-party dispute resolution process, which includes compulsory arbitration and that features penalties equivalent to those available for breaches of the ACL would likely prevent significant numbers of disputes from clogging the civil courts in every Australian jurisdiction, which reduces the overall regulatory burdens by a significant amount.

Q3 - DO YOU EXPECT THE COST TO BUSINESS TO DIFFER IF REFORMS ARE IMPLEMENTED THROUGH A STANDALONE AUTOMOTIVE CODE OR THROUGH AMENDING THE FRANCHISING CODE?

The AADA is of a strong view that the overall sum of regulatory costs is negligible regardless of whether progress is achieved through a stand-alone Automotive Code, or through a schedule or sub-part of the current Franchising Code. However, we believe that a coherent and comprehensive stand-alone Automotive Code could bring together elements that are currently being progressed through disparate agencies and processes, and thus reduce the amounts of separate legislation and regulation required. This would, by itself, significantly reduce the overall cost to business and cost to government.

ANSWER TO QUESTION 4

Q4 - DO YOU HAVE ANY VIEWS ON THE TRANSITIONAL ARRANGEMENTS? WOULD ALLOWING A 12-MONTH TRANSITION PERIOD TO UPDATE AGREEMENTS BE A SATISFACTORY APPROACH?

The AADA considers that a 12-month transition period is appropriate.

ANSWER TO QUESTION 5

Q5 - DO YOU HAVE ANY SUGGESTIONS ON HOW WE WOULD EVALUATE THE SUCCESS/FAILURE OF THE REFORMS?

The AADA believes that a two-year review period would be appropriate to assess the outcomes of the change. We would be happy to facilitate a monitoring process among our members as well as act as a conduit for Dealers to provide feedback on their experience.

CONCLUSION

I commend this submission to you and look forward to further supporting your work as it progresses.

I would be happy to meet with you to discuss our submission. If you require further information or clarification in respect of any matters raised, please do not hesitate to contact me or a member of the AADA team.

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