AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

AUTOMOTIVE FRANCHISING – NEW VEHICLE DEALERSHIP AGREEMENTS – DRAFT REGULATIONS 2020

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CONTENT

FOREWORD

The Australian Automotive Dealer Association (AADA) welcomes the opportunity to respond to the Department of Industry Innovation and Science's request for comments on the New Vehicle Dealership Agreements – Draft Regulations 2020.

We appreciate the Government's recognition that the automotive sector needs a specific set of protections to address the power imbalance in commercial relations between Manufacturers and new car Dealers. However, we are of the strong view that the draft regulations will not deliver on this intent and will in fact have a number of unintended negative consequences.

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.

Holden Dealers are now faced with the daunting prospect of battling a Fortune 100 company for adequate compensation to cover the significant investments they have made in the brand. This is not the first offshore car Manufacturer to withdraw from Australia and leave Dealers exposed and it will not be the last.

Original Equipment Manufacturers (OEMs) talk of the need for flexibility in managing their Dealer networks. The flexibility that currently exists allows Manufacturers to enter Australia and easily set up 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 and it is easy for Manufacturers to withdraw from Australia, reduce their Dealer networks and radically change their distribution model.

In countries such as the United States there is an appropriate cost of compliance for a Manufacturer looking at distributing motor vehicles through a network of Dealers. Automotive-specific laws in the US recognise the power imbalance and give appropriate protections to Dealers. US Dealers have perpetual agreements; they are protected against termination without cause; they are protected from regular and unnecessary requests to build or upgrade facilities; they have protections around warranty procedures. There are many other protections which acknowledge the gulf in power between OEMs and Dealers.

Unfortunately, these draft regulations do not provide similar protections to Australian Dealers. It is telling that Australian-based Manufacturers are lending their support to the draft regulations, presumably because they do not believe the requirements will make any material change to their operating standards.

The consequences of getting these regulations wrong cannot be underestimated. By the end of this year hundreds of new car Dealerships throughout Australia could be forced to close their doors. About 200 Holden Dealers will be shut after GM's decision to walk away from Australia. According to media reports, in a matter of weeks Honda is expected to cull up to three-quarters of its 100-strong Dealer network. There is evidence that other brands are also planning to rationalise their Dealer networks using short-term Dealer agreements as their preferred method of providing them with the flexibility they require to dismiss many Dealers easily with very short notice.

Businesses will close, investments will be wasted, and thousands of jobs will be lost. Many communities will see some of their major employers disappear. Throughout Australia new car Dealers are pillars of the community, which create jobs, deliver apprenticeships, use local suppliers and sponsor local sporting teams and charities.

Dealers are astute investors who run multi-faceted and complex businesses. However, even the most successful Dealers pale into insignificance compared to the financial might of the offshore car Manufacturers to which they are franchised.

These are Australian businesses that employ locals and pay their fair share of tax in Australia. They need stronger protections to protect both their investments and the many staff they employ.

AADA has made a number of recommendations in this submission as to how these regulations can be changed to deliver on the intention of providing a degree of balance to the relations between OEMs and Franchised new car Dealers.

James Voortman
Chief Executive Officer

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. Obligation on Manufacturers to buy back stock in the event of non-renewal.
3. Protections for Dealers against unfair warranty clawbacks.
4. A principles-based Industry Standard for Compensation for OEM's looking to withdraw from Australia, rationalise their networks or change their distribution models.
5. A definition of vehicle distribution in the regulations which capture future distribution models, including agency models.
6. 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.
7. 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.
8. Appropriate penalties for breaches of the regulations.

ISSUES NOT ADDRESSED IN THE DRAFT REGULATIONS

INSECURITY OF TENURE

The biggest issue influencing the power imbalance between Manufacturers and Dealers is the lack of security of tenure. In its retail market study into the new car market, 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 been completely ignored by these draft regulations.

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 (particularly in the case of a family business) to the 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. 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 Dealer Agreements are perpetual.

In the absence of a minimum fixed term, the AADA has suggested that these regulations 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.

The FCAI, the association representing Manufacturers, has stated that many of their members bring in low volumes of vehicles and should not be expected to deal with increased compliance costs. To accommodate their concerns, AADA suggests a possible exemption for brands who fall under a volume threshold of around 4,000 units per year.

OBLIGATION ON MANUFACTURERS TO BUY BACK STOCK IN THE EVENT OF NON-RENEWAL

This is something we believe is essential. By not requiring OEMs to buy back stock, there is a perverse incentive for some of them to load Dealers with stock and parts before a non-renewal notice is issued.

Some Manufacturers do the right thing and include clauses into Dealer Agreements in which they agree to purchase back stock in the event of a non-renewal. The draft regulations' explanatory statement makes the admission that leaving a non-renewed Dealer with significant stock risks the prospect of a fire sale of stock which is bad for Dealers and consumers. These regulations should formalise this conduct which is already the standard for Manufacturers which treat Dealers and their customers ethically.

We remain extremely concerned that the proposals for the end of term plan do not include a mandated requirement for the buyback of all vehicle stock, parts and specialist equipment on commercially fair terms. The injustice of this shortcoming is blatant, given that the franchisor mandated that the vehicle stock, parts and equipment be purchased by the Dealer, yet are somehow excused from being required to buy it back when they choose to not renew a franchise agreement. This is a major shortcoming of the draft regulations as circulated.

LACK OF WARRANTY AND ACL OBLIGATIONS

Industry Codes address industry specific issues. For example, the Food and Grocery Code of Conduct outlaws the issue of retailers forcing suppliers to make payments for shrinkages. One element which is very specific to the automotive industry is the requirement of Dealers to honour a Manufacturer's warranty. Some of the behaviours which OEMs practice in the warranty space requires a prescriptive solution.

The power imbalance allows OEMs to reject warranty claims by Dealers on unreasonable grounds. It also allows for the unfair practice of extrapolation of warranty audits and clawback of warranty funds. The Dealer is often caught between the customer and the Manufacturer in administering the Australian Consumer Law (ACL) - this is a big issue for our Dealers as it affects their bottom line and relations with customers. It stands to reason that any regulations which manage behaviour between Dealers and Manufacturers must address these issues not only to protect Dealers but also to protect their customers.

There is a clear opportunity here to establish a framework for appropriate behaviour in relation to warranty and ACL practices. This is a Code of Conduct and it should specify appropriate conduct in this regard, as it will benefit consumers.

INDUSTRY STANDARD FOR COMPENSATION

One of the issues highlighted by GM's dumping of Holden relates to the issue of compensation for Dealers. The compensation offered to Holden Dealers has been roundly rejected as grossly inadequate and demonstrated the need for an industry framework that can be used to determine the elements that reasonable compensation should include and a methodology for calculating it.

The automotive industry is in a state of flux and this Code of Conduct has the opportunity to provide a template for future cases in which a Manufacturer seeks to exit the country, rationalise its Dealer network or change its distribution model.

A principles-based *Industry Standard for Compensation* should establish a fair and reasonable framework which informs future compensation by Manufacturers.

ALIGNMENT OF TENURE AND LEASES

Another issue highlighted by the demise of Holden relates to the misalignment between the length of the Dealer Agreements and the leases Dealers enter into to service the brand. In many cases Dealers, in good faith and being told the brand was here to stay, signed up to leases for 10 years or more. The facilities demanded by Manufacturers are very unique and there are only so many parcels of land able to accommodate such facilities. Landlords of these properties hold all of the power and are usually unwilling to provide shorter-term leases.

These regulations should require or encourage some form of alignment between Dealer Agreements and the property leases Dealers enter in to.

SPECIFIC COMMENTS REGARDING SECTIONS OF THE DRAFT REGULATIONS

SUBCLAUSE 4(1)

The AADA submits that changes to the industry, particularly the use of the so-called "agency model" may challenge the strictures of the definitions of both a 'motor vehicle Dealership' and 'new vehicle Dealership Agreement'.

Although we believe an Agency Model as we understand it will be subject to the obligations of the Franchising Code, to avoid any risk that an Agency Arrangement is not captured by the Code, we recommend that the regulations should include a term that provides that the Code covers any form of motor vehicle distribution agreement including a pure Agency Model.

(SECTIONS 47-50) END OF TERM OBLIGATIONS

Reasons and 12-months' Notice - Franchisor

The AADA supports some of the end of term obligations which Manufacturers will need to adhere to when issuing Dealers with a non-renewal notice. The increase of the required notice period from six months to twelve months and the requirement for the provision of a reason for non-renewal are both welcome.

Unfortunately, the draft regulations have provided Manufacturers with the ability to opt out of these obligations. The draft regulations state that these requirements **only apply to agreements of 12 months or more**. This will almost certainly encourage some Manufacturers to offer sub-12-month agreements, further entrenching the power imbalance by further reducing tenure. It is unclear why this "12 months or more" element has been included in the draft regulations. At no time was it flagged during the consultation period and if allowed to remain in the final regulations, it risks rendering these new end of term obligations as irrelevant.

12 months' Notice – Franchisee

The AADA has no objection to the requirement of the franchisee to provide notice of their intention to renew or not renew an agreement, however, this requirement is largely unnecessary, given that when the Manufacturer provides their statutory notice it will facilitate a discussion with the Dealer around their willingness to renew or non-renew.

Managing the winding down of agreement

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 this 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.

(SECTIONS 51-52) SIGNIFICANT CAPITAL EXPENDITURE

The AADA supports the draft regulations removing the ability of franchisors to mandate expenditure solely on the grounds that they considered it 'necessary'. It is our understanding from talking to many of our members that Manufacturers often rely on marketing studies and strategies that require significant capital expenditure by the franchisee yet are unwilling to share the basis for their calculations, or the assumptions and studies that underpin them.

Consequently, we would argue that any agreement sought between the franchisor and franchisee to agree on particular capital expenditures needs to be made on the basis of freely entered agreements with both sides having access to identical levels and quality of information.

As noted earlier, 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 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 the principle that Dealership Agreements should enable Dealers to recoup the costs of any capital expenditure. However, we would submit that the actions proposed 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 53) RESOLVING DISPUTES

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 draft 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.

The failure to require franchisors to agree to multi-party resolution request effectively means that the facility will seldom or never be used. Just as franchisors do not enjoy discretion as to whether they will take part in a standard dispute resolution process, they should also have no option but to participate in multi-party dispute resolution processes. The obligation to act in good faith contained in the Franchising Code should extend to participating in multi-party dispute resolution processes when requested.

Furthermore, the draft regulations fail to deal with the potential impact of confidentiality obligations within Dealer Agreements. Dealers sharing details about a dispute with each other may put them in breach of confidentiality obligations contained in their Dealer Agreements. The final regulations need to address this point.

PENALTY PROVISIONS

The draft regulations allocate a civil penalty of 300 penalty units to a number of infringements. At the current penalty unit rate ($210), this yields a penalty for offence that is about $63,000. This level of civil penalty would not be considered even petty change by the vehicle Manufacturers that operate in Australia, such as General Motors' annual revenue (US$137,000,000,000), VW (US$278,000,000,000), or Nissan (US$104,000,000,000). The inadequacy of these penalties is reinforced by comments by the Chair of the ACCC regarding the A$10 million penalty levied on Ford, and by the recent court-allocated penalty on VW, which was set at A$128 million and that, to our mind, reflects present community expectations.[1]

While the allocation of civil penalties is a move in the right direction, the level of such penalties needs to be commensurate with both the damage caused by the offender's actions and their overall financial strength. Additionally, we consider that the Franchise Code could usefully be amended to incorporate a penalty regime like that under the ACL, which features the option for penalties to be assessed as a proportion of the corporate offender's annual turnover.

[1] "Ford ordered to pay $10 million fine for 'unconscionable conduct" , *by Rachel Clun, The Syndey Morning Herald, 26 April 2018*

CONCLUSION

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

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