AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

RESPONSE TO THE FRANCHISING CODE OF CONDUCT - EXPOSURE DRAFT

OCTOBER 2024

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FOREWORD

The Australian Automotive Dealer Association (AADA) welcomes the opportunity to submit a response to the Franchising Code of Conduct – exposure draft.

The AADA is the peak automotive industry body representing Australia's franchised car and truck Dealers. There are 3,179 new vehicle dealerships in Australia employing more than 61,000 people directly, including around 5,500 apprentices, and generating $73.9 billion in turnover and sales with a total economic contribution of over $18 billion.

The AADA notes that this consultation paper "is not about revisiting policy decisions", but the current situation in Australia's automotive franchising landscape is tenuous and there will be major consequences if steps are not taken to protect Australian Dealers and their 60,000 employees before the next review of this legislation in five-year's time. To this end we urge the Government to implement further amendments to the automotive franchising provisions of the Code.

Since the Schaper Review was handed down in February there have been several developments which all but guarantee significant structural change for the automotive industry, including:

- Legislation establishing Australia's New Vehicle Efficiency Standards
- A dozen Chinese manufacturers stating their intention to enter the Australian market
- Manufacturers seizing on the precedent set by Mercedes-Benz's move to an agency model

We are already seeing the consequences of these developments and Dealers being put at significant risk through unfair treatment by some multinational car manufacturers.

The changes required to comply with the NVES will result in manufacturers shifting the risk onto their Dealers. This will be compounded by the many new Chinese brands which have recently entered the Australian market. A record number of car manufacturers will be competing for sales in Australia. The consequences of this range from Dealers being put under pressure to report sales or make expensive investments to brands withdrawing from the Australian market.

We have heard the heads of car brands speak publicly about the risks of brands leaving the Australian market. We saw it with Holden in 2020 in which it was clear that the protections were inadequate. We saw it again with smaller brands such as Citroen and Chrysler. It is almost certain others will follow and the concerning thing is that there is now a blueprint which has been established by Mercedes-Benz.

Since the Mercedes-Benz case commenced in 2021 Dealers from a number of brands have reported that several OEMs have been emboldened and have targeted Dealers in a number of ways. Some of the behaviour we can report are:

- aggressive requests made of Dealers in relation to unrealistic stocking targets during a period in which high interest rates are putting Dealers under severe financial pressure
- pressure to achieve sales targets which are unachievable

- demands to commit to excessive capital expenditure on facilities with little tolerance for delays caused by planning or cost blowouts
- inclusion of unfair contract terms in Dealer Agreements

The consequences of complying with manufacturer demands can see a Dealer place themselves under significant financial hardship, jeopardising their business and the livelihoods of their employees.

The consequences of not complying with these requests range from a dealer being served with a breach notice, an OEM withholding critical remuneration from a Dealer, or a Dealer being threatened or issued with a notice of non-renewal.

The power of non-renewal has always been available to OEMs, but since the Mercedes-Benz case found that no "commercial goodwill" is payable upon non-renewal it has become a very powerful tool for OEMs seeking to exploit their Dealers.

Every exploitative and unreasonable request is now accompanied by the spectre of non-renewal. Even worse the Mercedes-Benz case demonstrated that non-renewal can be used as a tool to undermine years of collective investment by a network of Dealers and to compel those Dealers participate in a new business model in which commercial goodwill is transferred to the OEMs.

The AADA has put forward a series of modest amendments that would by no means completely level the playing field between Dealers and multinational car manufacturers, but would have the effect of proving protections in line with those that exist for Dealers in the US and the EU.

This is a matter of urgency for a sector that is in the midst of significant transition with Australian businesses subject to major vulnerability.

James Voortman
Chief Executive Officer

KEY POINTS

1. Implement amendments to the automotive franchising provisions of the Code.
2. Changing economic and industry market conditions leave automotive franchisees vulnerable.
3. Amendments to protect franchisee goodwill are needed urgently.
4. Franchised new car Dealers should be provided with a mandatory minimum term of 5 years with an option to renew for one further term.
5. Amend the definition of a New Vehicle Dealership Agreement under Part 6 (formerly Part 5) to capture businesses where the service and parts business is conducted by a different entity to the dealership entity and standalone franchised service centres.
6. The AADA urges consideration of the recommendation's made in our response to the Schaper Review in September 2023.

ENSURING THE CODE REMAINS FIT FOR PURPOSE

Recommendation 2: The Code should be remade, largely in its current form.

The AADA considers the Franchising Code of Conduct (the Code) to be the most important regulatory mechanism for protecting franchisee rights in Australia. This is particularly so for the automotive franchising industry due to the introduction of Part 6 (formerly Part 5) of the Code which relates to new vehicle dealerships.

As such the AADA does not agree with the premise that the Code largely remains fit for purpose. The Schaper Review found that the current Code could better articulate the intent to address the power imbalance between franchisors - franchisees and prospective franchisees, and should convey that the Code is intended to raise standards of conduct and encourage best practice. However, as demonstrated in the automotive industry over the past few years, the Code has many shortcomings in its current form and there are several key areas where the Code does little to address this power imbalance and the resulting negative consequences for Dealers.

These are detailed extensively in the AADA's response to the Schaper Review, which includes protection of franchisee goodwill and insecurity of tenure.

Goodwill

The current lack of protection of franchisee goodwill in the Code was prominently demonstrated in the Mercedes-Benz (MB) case (attached as appendix A of the submission). This case highlighted how the inadequacies of current franchising protections enabled the Original Equipment Manufacturer (OEM) to exploit Mercedes-Benz Dealer goodwill and prompted the Federal Court judge to state that the Franchising Code of Conduct needed to be revisited:

"It will be apparent from the reasons that I am publishing that the applicants were successful on many issues of fact but lost on the law, essentially".

"given the facts of this case leading to an adverse result for the applicants, it may be that further consideration needs to be given to the terms of the franchising code and possible modification, but that is a matter for another day and, obviously, in another forum".

The Hon Justice Jonathan Beach, Federal Court of Australia.

The strong remarks delivered by Justice Beach warrant explicit examination of this issue which if not addressed could have far-reaching consequences for not just automotive franchisees but confidence in Australia's wider franchising industry.

The Mercedes-Benz judgment exposed a difference between the narrow 'legal' concept of goodwill – which expires at the end of an agreement, and commercial or accounting goodwill. Finding that, without

a franchise agreement, the business effectively loses any goodwill the business built as there is no legal framework to support goodwill compensation at the expiry (and non-renewal) of a franchise agreement.

This lack of recognition of goodwill once a franchise agreement ends, enables franchisor opportunism and further reinforces the significant power imbalance which exists between franchisees and franchisors.

The AADA has attached as Appendix A, a comprehensive overview of the implications of the Mercedes-Benz case, and amendments to clauses 46A and 46B of the Franchising Code to close the key loopholes identified and clarification to clause 6(3A).

The AADA strongly urges that this loophole be addressed now as part of the Government's proposed reforms. If franchisees are left with no recourse for a franchisor's poor behaviour, prospective and current franchisees could lose confidence in Australia's franchising sector, and it may be too late to rectify this loss of confidence in the industry when the next review of the Code is conducted in 5 years' time.

Insecurity of tenure

While goodwill is an example of franchisors using their power advantage for their own exploitative purposes, the single most critical factor in continuing to enable this immense power imbalance is the issue of tenure insecurity.

Franchised new car dealers make substantial capital investments in business facilities required by their OEM in franchise agreements and then face the prospect of short-term franchise agreements, sometimes as brief as one year, offered on a take it or leave it basis. The inflexibility of being able to transition to another brand easily due to brand-specific business prerequisites (such as design features of dealership sites) puts Dealers in a difficult position and forces them to either accept shorter agreements or lose the brand altogether, and as outlined above, any goodwill the business has built.

The issue of tenure insecurity is further exacerbated by the sweeping powers of non-renewal and termination available to franchisors. Almost every Dealer agreement in Australia has a clause giving the OEM power to issue a non-renewal without cause notice. While the AADA acknowledges that most franchise agreements have a limited term, there is an implied renewal in these agreements so long as the franchisee is meeting their performance obligations.

OEMs also often put investment requirements in the franchising agreement when it comes time for it to be renewed, and due to the vulnerable position dealers are in they often have to accept the notion that they will be able to recoup investment costs within the agreement term (as required by Part 46B of the Code) even if they believe this not to be the case. If the dealer tries to negotiate with the OEM in good faith on the investment requirements of the agreement, they face the prospect of the OEM withdrawing the agreement renewal.

This issue could be rectified with mandatory minimum terms for franchises with significant investment requirements.

Recommendation 4: Service and repair work conducted by motor vehicle dealerships should be explicitly captured by the Code.

The AADA welcomes the implementation of Recommendation 4 to ensure that the new Code clarifies that service and repair work performed by motor vehicle dealerships is within the scope of the Code.

The AADA agrees that the revised definition of 'motor vehicle dealership' contained in Part 6 (formerly Part 5) explicitly captures any servicing or repairing of motor vehicles conducted by dealers or associated with a dealership agreement that buys, sells, exchanges or leases motor vehicles.

It is evident however that these amended definitions still leave opportunities for franchisors to escape their obligations under the Code.

For example, the new definition will not cover:

a. If a Service & Parts business is conducted by a different entity to the dealership entity; or

b. An entity which only undertakes a stand alone Service & Parts business such as the former Holden dealers,

unless the Service & Parts Agreement fits the traditional definition of franchise agreement in the Code - which is not always clear.

Also, a further limitation of the proposed amended definition of motor vehicle dealership is that if an entity has an Agency Agreement and Service & Parts Agreement but the Agency Agreement is terminated at a later date, the Service & Parts Agreement will no longer be

covered by the Code (unless it falls with the definition of franchise agreement in clause 5 of the Code).

The AADA recommends a simple change to the definition of a New Vehicle Dealership Agreement under Part 6 (formerly Part 5) to resolve this issue.

motor vehicle dealership:

(a) means a business of:

i. *buying, selling, exchanging or leasing motor vehicles that is conducted by a person other than a person who is only involved as a credit provider, or provider of other financial services, in the purchase, sale, exchange or lease; and*

ii. *any servicing or repairing of motor vehicles by that business; and*

iii. *offering or carrying out any other service at the direction of the franchisor; and*

(b) includes a business of:

i. *selling motor vehicles that is conducted by a person (for the purposes of this instrument, the franchisee) who sells the motor vehicles as an agent for a principal (for the purposes of this instrument, the franchisor); and*

ii. *any servicing or repairing of motor vehicles by that business; and*

iii. *offering or carrying out any other service at the direction of the franchisor.*

Recommendation 5: Reviews of the Code should be conducted in five yearly cycles in the future.

The AADA welcomes 5 yearly reviews of the Code to ensure it is delivering on its updated purpose and is operating efficiently and effectively. However, the AADA would also call for flexibility in reviewing the Code to allow for potential reviews in the interim if necessary.

The current economic climate, and particularly for the automotive industry, the introduction of the New Vehicle Efficiency Standard means that market conditions can change rapidly and leave franchisees exposed to poor practices by their franchisor. The Code must be nimble to ensure that it continues to deliver on its intended, overarching purpose of ensuring that there is a fair and balanced relationship between franchisors and franchisees.

EXTENDING KEY PROTECTIONS

Recommendation 8: The existing requirement that new vehicle dealership agreements must provide a reasonable opportunity to make a return on investment should be extended to all franchise agreements.

Recommendation 9: The existing requirement that new vehicle dealership agreements must include provisions for compensation for franchisees in the event of early termination should be extended to all franchise agreements.

The AADA welcomes the implementation of Recommendations 8 and 9, which extend two protections currently captured in Part 6 (formerly Part 5) of the Code to all franchisees. These important protections provide a reasonable opportunity to make a return on investment and also include provisions for compensation for franchisees in the event of early termination.

This is a welcome development for the AADA who has consistently called for the protections afforded to new car dealerships to be extended to all automotive dealerships such as trucks, motorcycles and farm machinery.

However, the AADA considers that the full suite of protections afforded to new car dealers in Part 6 (formerly Part 5) should be extended to all automotive dealers. The several key factors which warranted further regulation in the Code for new car dealerships also apply to OEM/Truck Dealer relationship. These include:

- The requirement by OEMs for high levels of capital expenditure by truck Dealers to invest in expensive facilities, stock, tools and suitably qualified and trained personnel.
- Unique facilities such as bespoke showrooms and workshops are distinctive and very difficult to repurpose.
- Truck Dealers are significant employers relative to other franchisees and have staff across various departments such as sales, service and repair and finance and insurance
- OEMs are all subsidiaries of powerful offshore multi-national companies which are among the largest in the world.
- Trucks are an incredibly high value product which are mechanically and technologically sophisticated relative to other goods.
- There is an extended after-sales relationship between a truck Dealer and its customers.

Dealer Agreements in the truck industry generally provide no provisions for compensation in the event of early termination or non-renewal and because of the lack of protections, Dealers may be threatened with short-term agreements if Dealers refuse to comply with requirements introduced by the franchisor.

Section 4

The power imbalance experienced in the car sector is exacerbated in the trucking sector because the truck market is even more concentrated. Facility requirements for truck Dealers are generally like those of car Dealers with regards to signage and dealership design but truck Dealers have to be considerably larger and have bigger workshops. These often more onerous requirements translate to truck Dealers having large sunk costs in their business and this can be used opportunistically by some franchisors to force through their wishes and get Dealers to sign unfair agreements.

Not extending the new car dealer protections to other motor vehicle dealers as part of this review is a missed opportunity, and the AADA would call for an urgent examination of this issue with a view to extending these protections to all automotive dealers well before the 5 yearly review scheduled in 2030.

OTHER COMMENTS

Dispute resolution

The AADA considers that one of the biggest shortcomings of the Code is the weakness of the dispute resolution process and is disappointed that this has not been addressed in the Schaper Review or Government Response.

The Code's fundamental purpose is to address the inherent power imbalance between franchisors and franchisees, when these relationships break down and franchisees need a cost-effective, timely and determinative outcome, the Code fails to deliver on correcting this imbalance.

While the AADA always welcomes changes to the Code to improve dispute resolution processes. Unfortunately, when an OEM or franchisor is not interested in engaging in good faith mediation or arbitration, the changes introduced to dispute resolution under the Code, including allowing for voluntary binding arbitration, fall short in protecting franchisees.

Successful mediation relies on both sides coming to the table and working towards a fair resolution. There have been recent instances where OEMs are not inclined to negotiate, particularly, when the local management is acting on instructions from the offshore head office. When mediation fails and franchisors are unwilling to settle the dispute through arbitration, the only option for franchisees is to either comply with the franchisor's terms or to seek redress through the court system.

Legal action against a franchisor is a grim prospect, and particularly so for the automotive industry, where even the most well-resourced dealers pale in comparison to the resources that the OEMs have at their disposal. With large internal legal departments and deep pockets, multinational, often hundreds of billion-dollar revenue OEMs, have access to the best legal representation money can buy for as long as they need it.

As discussed in our initial response to the Franchising Code Review, we see merit in the advocated position by the Australian Small Business and Family Enterprise Ombudsman, for a Federal Small Business Codes List to be created in the Federal Circuit Court of Australia and expanding such an initiative to all franchisees.

The AADA is cognisant of the constitutional limitations of mandating arbitration as a form of dispute resolution and sees this proposal as a sensible way forward to correct this current lack of timely and cost-effective dispute resolution processes for franchisees.

Unfair Contract Terms and Trade Practices

The AADA is encouraged by the recent changes to Unfair Contract Terms (UCT) laws which took effect late last year and considers that these will help strengthen protections for small businesses from unfair terms in standard-form contracts.

This provides increased protections for Dealers who qualify under the new thresholds; however, many Dealers are not covered by these protections. The AADA has for some time been calling for all franchisees to be included in these protections, irrespective of turnover of employee count, in recognition of the immense disparity in bargaining power between automotive franchisees and franchisors.

Furthermore, in New South Wales, the Motor Dealers and Repairers Act 2013 ensures that all Dealers are protected from unfair terms in contracts for the supply of motor vehicles by OEMs to motor Dealers. Dealers across Australia are currently operating under a patchwork approach to UCT protections, whereby coverage is determined by the size of your workforce and the location of your business.

The AADA also notes possible reforms to address currently unregulated Unfair Trading Practices (UTP) which currently fall outside the scope of the Australian Consumer Law, despite causing considerable harm to consumers and small businesses. However, in a similar fashion to UCTs, the AADA has concerns that these protections will also be limited in its protection of franchisees.

The implementation of these very important protections against UTPs should be extended to all franchisees due to the inherent power imbalance in their commercial arrangements with their franchisor.

CONCLUSION

We would be happy to meet with you to discuss our submission and participate in any further consultation. If you require further information or clarification in respect of any matters raised, please do not hesitate to contact me.

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