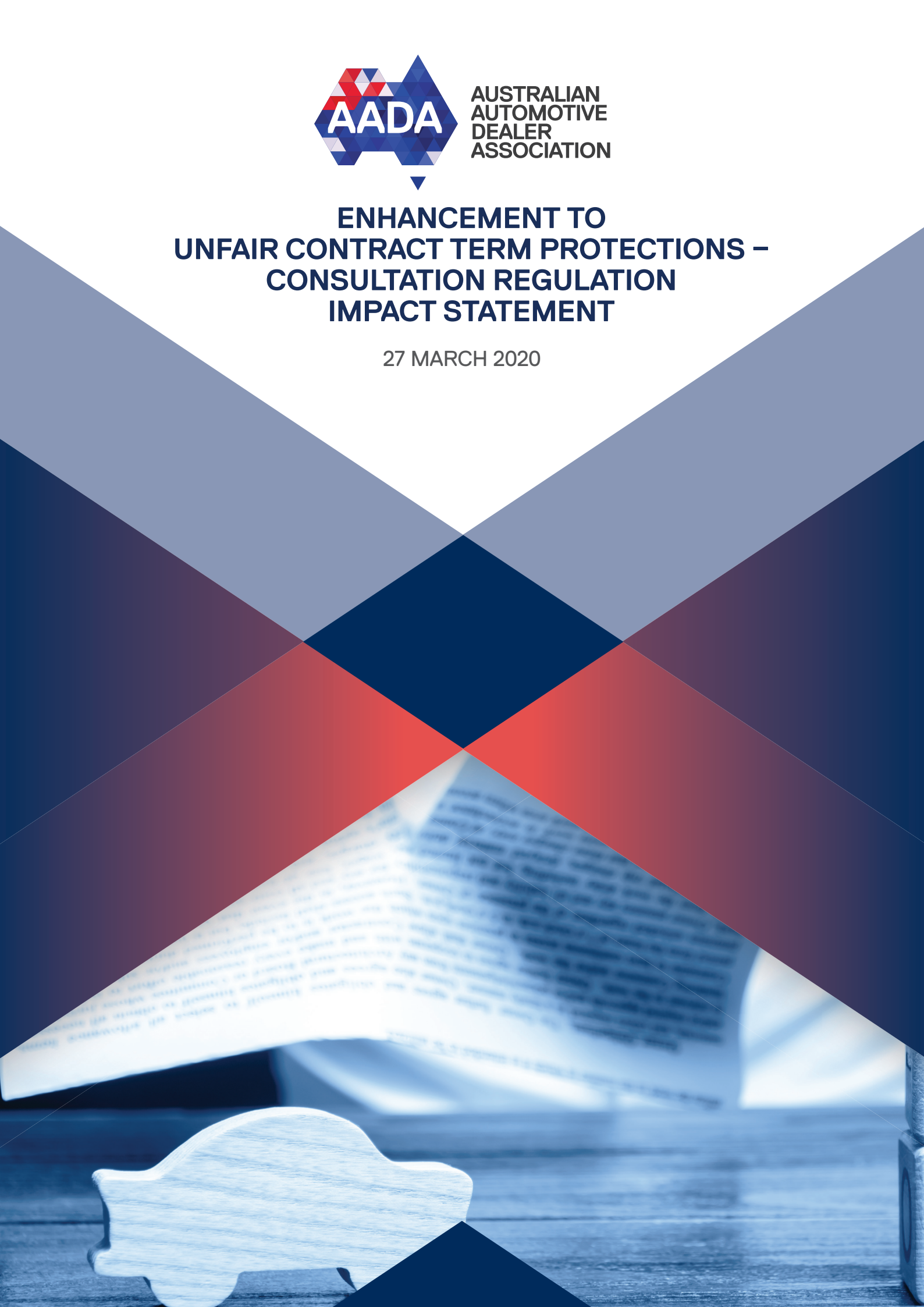
AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

ENHANCEMENT TO UNFAIR CONTRACT TERM PROTECTIONS – CONSULTATION REGULATION IMPACT STATEMENT

27 MARCH 2020



CONTENT

FOREWORD

"UNFAIR CONTRACT TERMS ARE NOT ILLEGAL. (BUT) THEY SHOULD BE!"

Rod Sims – ACCC Commissioner – 31 Aug 2018

The Australian Automotive Dealer Association (AADA) is the peak industry advocacy body exclusively representing franchised new car Dealers in Australia. There are around 1,500 new car Dealers in Australia that operate more than 3,000 new vehicle outlets. About 85 per cent of those new car Dealers are either independent operators or belong to family groups and private companies. Those Dealers are effectively very small businesses in comparison with the major overseas vehicle manufacturing corporations to which they are franchised.

The automotive retail sector in Australia is one of the most competitive in the world. Around 70 brands offer some 400 models for sale in a relatively small market of about one million units annually (less than 1.5 per cent of global demand). The competition means there is significant pressure on the Australian subsidiaries of the global automotive Manufacturers and by extension their franchised new car Dealer networks to achieve sales targets. The pressure that local subsidiaries are under was sharply demonstrated recently when General Motors abruptly closed down the Holden brand due to continuing poor sales since the end of local vehicle manufacturing in Australia. In truth, success in this highly competitive industry is by no means assured and franchised new car Dealers often run on razor thin profit margins.

New car Dealers in Australia are franchised to the global automotive Manufacturer brands or Original Equipment Manufacturers (OEMs). Dealers who enter into a contract (Dealer Agreement) with an OEM are given the exclusive right to market and sell new vehicles and associated services within a specific geographic location or marketing area. In return, Dealers are bound by these Dealer Agreements, the terms of which are very much skewed in favour of the OEM. New motor vehicle Dealerships fall under the definition of a franchise as defined in the Franchise Code of Conduct.

At this point it is worth noting that most franchisees covered by the Franchising Code of Conduct also enjoy protections from the Australian Consumer Law (ACL) Unfair Contract Terms provisions on new, renewed and terminated franchise agreements since 12 November 2016. Unfortunately, franchised new car Dealers, have not benefited at all due to the "small business" threshold requirements of the legislation. Small business is defined in the ACL unfair contract terms legislation as a business employing fewer than 20 employees and almost all franchised new car Dealerships in Australia exceed this number of staff. The AADA contends that a strict limit on definition of a small business for the purpose of UCT protection does not adequately address the circumstances where the power differences between a franchisor and its franchisee is so large as to make it impossible for contracts to be negotiated on a level playing field. In this respect we welcome current reconsideration of coverage for UCT protection, but would argue that the recent Parliamentary Inquiry into the Franchise Code had the right of it in its recommendation as listed below:

> *9.68 The committee recommends that the Franchising Taskforce examine how to amend section 23 of Schedule 2 of the Australian Consumer Law to provide that unfair contract terms provisions apply to all franchise agreements notwithstanding any other term in the franchise agreement or other agreements.*

The lack of capacity and bargaining power of Dealers, combined with long term commercial relationships and significant sunk investment, results in franchised new car Dealers choosing to enter into contractual agreements which contain oppressive contractual clauses, or which permit Manufacturers to engage in opportunistic and/or exploitative conduct through unilateral changes to the franchise agreements or subsidiary documents. Specifically, Dealer Agreements most often include reference to Policies and Standards that are set by the OEM and that can be changed unilaterally by the OEM.

The real-life effect for our members is that they may have signed Dealer Agreements in good faith that are predicated on sole access to a particular marketing area, and on a specific set of targets and incentives. The OEM can reduce the marketing area, increase targets, or make warranty processes unworkable, and decrease incentives unilaterally, thus making the contract onerous and unprofitable, without the Dealer having any recourse. These are some of the reasons why new car Dealers, irrespective of their apparent size, urgently need protection against the imposition of Unfair Contract Terms.

We commend this submission for your consideration.

James Voortman
Chief Executive Officer

AADA KEY RECOMMENDATIONS

1. The Government adopt Recommendation 9.68 of the Parliamentary Inquiry into the Franchise Code and provide UCT protections to all franchisees.

2. It adopts a workforce of less than 100 (full time equivalent) staff as the criterion to define a small business.

3. A ‘standard form contract’ be defined as one in which the franchisee does not have an ‘effective opportunity to negotiate’.

4. It implements strengthened powers for regulators.

5. Make Unfair Contract Terms unlawful and attach effective penalties for their use.

GENERAL COMMENTS

While we will be focussing our comments around the discussion questions related to franchises, the AADA would like to briefly address a number of broader issues.

RELATED BODIES

The AADA submits that the idea that a business such as a new car Dealership that belongs to a larger group of businesses is managed directly and on a daily basis through some sort of downwards reach from head office reveals an improper understanding of modern business dynamics. Consequently, we would argue that it would be counter productive to sum all related corporate bodies into one total to assess against the definition of a small business to check whether they merit protection against unfair contract terms.

VALUE THRESHOLD

The AADA submits that new car retailing, like farming, is capital intensive and exhibits high turnover and very low profit levels. Further, there is normally no payment to be made to the franchisor at the commencement of a Dealership Agreement. It is unclear whether these characteristics would exclude many new car Dealerships from UCT protections under the value threshold as currently defined.

FRANCHISING

Question 30 – How would the options for defining small business (in Section 6) apply to franchisees and franchisor businesses, and what proportion of franchisees would be a small business under each of the options?

Our membership is made up of a wide range of businesses, ranging from small to two public companies. Regardless of apparent size, they are dwarfed by the scale of the multinational corporations that are their franchisors. This power imbalance is a common feature of franchisor/franchisee relationships but it is at its most evident for new car Dealerships. With respect to each of the options listed, please note.

Option 1 – Status Quo

The AADA submits that very few, if any, of our members would be eligible for UCT protections under this option.

Option 2 – Replace headcount threshold with turnover threshold

New car Dealerships are capital-intensive organisations that exhibit high turnovers due to the nature of the products and services they provide. They also, like agriculture or many other businesses such as fuel retailers, operate on very slim profit margins. It is our submission that very few, if any, of our members would be entitled to UCT protections under this option.

Studies from Deloitte Motor Vehicle Services indicate average Dealer profitability has been around 0.4% - 0.9%.[1] The match between high turnovers and low profitability makes Dealers almost uniquely susceptible to UCTs in their Dealer Agreements and subsidiary documents.

Option 3 – Headcount threshold or turnover threshold

The AADA submits that an increased threshold (100 persons) would likely capture the majority of stand-alone Dealership operations. We would submit that such an increased threshold would need to take into consideration 'full-time equivalent' number of staff so as to account for part time workers. It is unclear to us how contractors or subcontractors would be counted under this option.

Should the headcount not be increased to 100 persons, we would submit that very few, if any, new car Dealers would be eligible for UCT protection under either the headcount or turnover thresholds.

[1] https://premium.goauto.com.au/dealer-profitability-at-0-4-per-cent-deloitte/, accessed 16 March 2020.

Question 31 – Will changes to the value thresholds for contracts (section 7) apply to franchise agreements, and what proportion of franchising agreements would be captured under each option'.

The AADA would submit that new car Dealerships are not characterised by up-front contract payments. While Dealers incur significant expenses for vehicle and parts stock, as well as compulsory capital expenditures as part of their franchise obligations; upfront franchise fees to the franchisor are not a characteristic of auto retailing. Consequently, it may be that Dealerships are excluded from UCT protections because they do not pay upfront fees as part of their Dealership Agreement. The AADA submits that this would be a perverse outcome that is surely not intended by the regulatory framework.

Question 32 – How would the options for clarifying a standard form contract (Section8) apply to franchise agreements, and what proportion of franchisee agreements would be a standard form contract?

As noted earlier, the power imbalance between an overseas vehicle Manufacturer and a local new car Dealer is immense. Based on discussions with our members, it is clear that Dealership Agreements meet the characterisation of a standard form contract as listed in section 8.1 of the Consultation RIS in that:

- The Manufacturer has all the bargaining power relating to the transaction,
- The draft agreement is prepared by one party before any discussion
- The prospective new car Dealer is required to accept or reject the terms of the contract in the form in which they are presented. Additionally, Dealers are required to accept the power of the Manufacturer to make unilateral changes to the agreement and subsidiary documents.

Given the above, the AADA submits that all Dealership Agreements meet the definition of a standard form contract as described in the Consultation RIS.

With respect to the options presented, we submit the following:

Option 1 – status quo

There is little doubt in our mind that Dealership Agreements meet the definition of a standard form contract. As such, this option would not impact the applicability of the UCT provisions for new car Dealers.

Option 2 – repeat usage

Discussions with our members indicate that vehicle Manufacturers have a standard form contract that they issue to prospective Dealers. As such, they would meet the requirement of repeat usage for defining a standard form contract.

Option 3 – defining 'effective opportunity to negotiate'

The AADA submits that vehicle Manufacturers do not provide prospective Dealers with an effective opportunity to negotiate, and that the terms of the contract are essentially set for the Dealer to sign. We believe that such circumstances are very common in franchise considerations, thus agree most strongly with the recommendation of the Parliamentary Inquiry into the Franchise Code that all franchisees should be granted protection from UCTs based on the fact that they are franchises and thus subject to:

- Standard form contracts.
- A lack of effective opportunities to negotiate.
- Suffering a substantial power imbalance with respect to the franchisor.

Question 33 – How will the different penalties, infringement notices and enforcement options (Section 4) apply in the franchising sector? Would they be appropriate for franchise agreements?

The AADA agrees with the Consultation RIS that there is a massive lack of deterrence with respect to the inclusion of UCTs in standard form contracts as they are neither unlawful nor do they attract a penalty. Our submission with respect to the listed options is as follows:

Option 1 – status quo

The AADA submits that this option is not viable, and that adopting it would further entrench and worsen the already significant power imbalance that is commonly seen, specifically in our industry, between franchisor and franchisee.

Option 2 – strengthened compliance and enforcement activities

The AADA is sceptical about the value of strengthened compliance and enforcement activities given the absence of either legal sanction or effective penalties. It is our view that overseas vehicle Manufacturers would see dealing with any such activities as simply the cost of doing business. They would effectively navigate around them and leave their franchisees to suffer.

Option 3 – making UCTs illegal and attaching penalties

We agree that the only way to deal effectively with the prevalence of UCTs is to make them illegal and attach strong penalties to their use. To make such initiatives effective will also require strong compliance and enforcement activities. New car Dealers in particular, and all franchisees in general, will benefit greatly as franchisors will not be able to transfer risk to small business through the issuing of standard form contracts that contain UCTs.

We consider that a stepped approach that allows for minor breaches to be dealt with through infringement notices and scales up to significant civil penalties is a suitable basis for addressing the occurrence of UCTs in franchise agreements and in subsidiary documents.

The challenge will be to incorporate a penalty regime that acts as a sufficient deterrent for the more serious breaches and thus encourage franchisors to draft standard form contracts that do not contain UCTs. We consider that a suitable penalty regime is that applied to breaches of the ACL, which since 2018 allows for companies that contravene certain provisions of the ACL to face maximum penalties of up to $10 million per contravention or up to three times the value of the benefit obtained from the breach. Where the value of the benefit cannot be determined, the Court can order a penalty of up to 10% of a company's annual turnover.

Option 4 – Strengthened powers for regulators

Option 4a – Infringement notices

The AADA supports the proposal to make UCTs illegal and attach appropriate penalties that will act as real deterrents to franchisors which, in our industry include several Fortune 100 companies. We also support the proposal to stiffen compliance through the granting of strengthened powers for regulators.

We consider that such strengthened powers would be required for regulators to be able to issue infringement notices for lesser offences where the offender admits liability and remedies the offending contract terms. Business practices would need to be developed so that franchisors are first given a warning, and if the matter is still not resolved, issued an infringement notice.

Our experience is that subsidiary documents such as Operations or Warranty Manuals that can currently be amended unilaterally by franchisors would be likely targets for this level of compliance. The prevalence of UCTs in subsidiary documents, and the power of franchisors to make changes to them unilaterally was addressed in the Parliamentary Inquiry into the Franchise Code. Recommendations 9.7 and 9.8 addressed the issue of unilateral changes to contracts and subsidiary documents, respectively. Banning unilateral changes to subsidiary documents would bring greater visibility to UCTs in such documents and enable more appropriate compliance actions.

We agree that circumstances that revolve around definitional issues would still require court proceedings.

Option 4b – Regulator determinations

While it would nominally be advantageous to get a regulator determination as to whether certain contract terms are unfair, the AADA considers that such a mechanism would be unwieldy, expensive and time consuming. Our concern is that any such approach would be quickly overwhelmed, leading to its consequent abandonment.

We concur with the Consultation RIS that for more serious breaches, the public nature of court proceedings and detailed public judgements should act as a strong deterrent and guide for other businesses seeking to avoid the use of UCTs both in their principal agreements and their subsidiary documents.

Question 34 – What proportion of franchise agreements are perpetual or evergreen, and how could UCTs in these agreements be addressed?

Franchise agreements for new car Dealerships do not generally involve perpetual or evergreen agreements. We understand that there are a few such agreements extant, but they are extraordinarily rare in our industry.

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:

James Voortman
Chief Executive Officer
M: +61 452 535 696
E: jvoortman@aada.asn.au

Alex Tewes
Policy Manager
M: +61 41 842 5820
E: atewes@aada.asn.au

CANBERRA OFFICE
Level 3, 10 National Circuit, Barton ACT 2600
PO Box 4409 Kingston ACT 2604

MELBOURNE OFFICE
Level 4, Suite 12, 150 Albert Road,
South Melbourne VIC 3205

E info@aada.asn.au

aada.asn.au