

Regulation Impact Statement

Franchise relationships between car manufacturers and new car dealers

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1. Introduction

In its 2017 market study of new car retailing (market study), the Australian Competition and Consumer Commission (ACCC)¹ made a number of recommendations aimed at addressing concerns within the new car retailing market which were leading to suboptimal outcomes for consumers and hindering effective competition.

As part of its market study, the ACCC examined the inter-relationships between the three key groups of entities in the car retailing supply chain – large multi-national car manufacturers (who are often represented by locally based distributors); new car dealers; and independent businesses that service and repair cars (the Australian car retailing industry is further discussed at Appendix 1).² The ACCC noted that some of the competition concerns within the new car retailing market stem from the power imbalance in the commercial relationships between the large car manufacturers and the other two groups of entities – new car dealers and independent repairers.³

Firstly, while voluntary commitments had been made by car manufacturers to provide independent repairers with the same technical information to repair and service new cars that they provide to their dealers, there are problems with the breadth, depth and timeliness of the information offered.⁴ Given this, the ACCC supported a mandatory scheme to compel car manufacturers to provide independent repairers equivalent service and repair information (mandatory information sharing).⁵

Secondly, while the Australian Consumer Law (ACL) provides protections to consumers through the consumer guarantees provisions, there are a number of systemic problems in the new car industry preventing consumers from obtaining the remedies to which they are entitled.⁶ One of which is the power imbalance between car manufacturers and their dealers, in favour of the car manufacturer, which means that car manufacturers are able to impose commercial terms on dealers which make it difficult for dealers to provide satisfactory outcomes for consumers (more information is provided at Box 1).⁷ The ACCC also recommended that other issues raised by dealers relating to the imbalance of power in their

¹ Australian Competition and Consumer Commission, [New car retailing industry market study - final report](#), 2017, ACCC.

² ACCC 2017 (Ibid footnote 1).

³ ACCC 2017 (Ibid footnote 1).

⁴ ACCC 2017, p. 10 (Ibid footnote 1).

⁵ ACCC 2017, p. 12 (Ibid footnote 1).

⁶ ACCC 2017, pp. 4-9 (Ibid footnote 1).

⁷ ACCC 2017, p. 8 (Ibid footnote 1).

commercial arrangements with manufacturers, such as insecure tenure and significant capital outlays expected of dealers, be examined further.⁸

In line with the ACCC's findings, in 2018 the Government committed to a mandatory information sharing scheme between car manufacturers and independent repairers. In August 2019, the Government announced that it would pursue regulatory reforms to address concerns about the commercial relationships between car manufacturers, as franchisors and new car dealers, as franchisees. While there are other franchise arrangements in the automotive sector, for example, some service and repair brands operate under franchise arrangements, only the arrangements between new car dealers and manufacturers are being considered in this Regulation Impact Statement (RIS).

The franchising relationship between car manufacturers and dealers is subject to the Franchising Code⁹, a mandatory code under the *Competition and Consumer Act 2010* (CCA). The Parliamentary Joint Committee on Corporations and Financial Services completed its Inquiry into the operation and effectiveness of the Franchising Code of Conduct (PJC Inquiry) and released its report '*Fairness in Franchising*' on 14 March 2019 (PJC Report). The PJC report examined the existing regulatory framework for franchises and the suitability of the protections provided to franchisees. The PJC Report made a number of recommendations for franchising generally, with two directly relevant to the automotive industry. The Government's Franchising Taskforce is considering the general recommendations through a separate process and they are outside the scope of this RIS. The recommendations regarding the automotive industry broadly align with the options supported in this RIS and are discussed within the analysis of each option. The PJC Report also recommended¹⁰ that the Government consider 'establishing a core franchising code that applies generally, with industry-specific aspects in schedules or sub-codes', noting that the issues raised are not unique to the auto industry and addressing through the Franchising Code is appropriate. The Department of Industry, Science, Energy and Resources (DISER) consulted stakeholders on the different implementation options, such as a standalone code, amending the Franchising Code and a voluntary code. In consideration of the PJC findings and feedback received from stakeholders during the RIS consultation, the RIS supports implementation of the reforms through industry specific amendments to the Franchising Code in line with the PJC recommendations. This is discussed in greater detail at Chapter 7 – Implementation.

⁸ ACCC 2017, p. 9 (Ibid footnote 1).

⁹ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1.

¹⁰ Recommendation 17.2, Parliamentary Joint Committee on Corporations and Financial Services 2019, *Fairness in Franchising*, March 2019, pp. 235.

This RIS identifies four options for regulatory intervention which will have a positive net benefit. Together these options seek to address the identified problems in the new car retailing sector in scope for this RIS:

- Option 2A – requiring manufacturers and dealers to provide at least 12 months’ notice when not renewing a dealer agreement. It will also require manufacturers and dealers to discuss, plan and agree end of term arrangements when not renewing an agreement.
- Option 2B – requiring manufacturers and dealers to provide a statement to the other party outlining why a dealer agreement is not being renewed.
- Option 2D – requiring pre-contractual disclosure of significant capital expenditure to have a greater degree of specificity.
- Option 2F – enabling multi-franchisee mediation.

The cumulative average annual regulatory burden for the above four recommended sub-options is about \$4.575 million identified in the table on page 44.

Other options which are also considered include:

- Option 1 – Maintaining the status quo.
- Sub-option 2C – Mandating that manufacturers buy back stock when an agreement is not renewed.
- Sub-option 2E – Minimum five year terms with right of renewal.
- Option 3 – Voluntary Code of Conduct.

2. Overview of this Regulation Impact Statement

This RIS has been developed to inform Government decision making and provide an evidence base. This is consistent with the Government’s commitment to improving the quality of regulation, including minimising the burden of regulation on businesses, community organisations and individuals. The Government’s regulatory policy frameworks assist in keeping the Australian economy as efficient, flexible and responsive as possible. Under the Government’s Regulatory Impact Analysis system, every policy proposal designed to introduce or abolish regulation must be accompanied by a RIS.

While the ACCC noted new car dealers' concerns with the power imbalance in their franchising relationship with new car manufacturers, it recommended Government further consider dealers' specific concerns.¹¹ In addition, industry submissions to the PJC Inquiry and to the earlier consultation version of this RIS indicated that while there may be some agreement on key concerns for dealers, as franchisees, in their dealings with car manufacturers, as franchisors, there is no firm agreement on the best way to address dealers' concerns – whether through amendments to the Franchising Code, specific provisions within a standalone Automotive Code or a voluntary code of conduct. This RIS defines the policy problems to be addressed and canvasses the policy solutions. It provides an assessment of the costs and benefits of policy responses, and identifies the most effective method of implementation. This RIS categorises dealer concerns into three themes as follows:

- (1) End of term arrangements contained in dealership agreements including:
 - (a) Insufficient notice periods for non-renewal of dealership agreements;
 - (b) Providing reasons for non-renewal; and
 - (c) Stock buy-back arrangements when dealership agreements are not renewed;
- (2) Ability to recoup capital expenditure during the term of the dealership agreement:
 - (a) enhanced disclosure requirements;
 - (b) minimum tenure with right of renewal for the dealer; and
- (3) Improving the effectiveness of dispute resolution.

The Motor Trades Association of Australia (MTAA) and the Australian Automotive Dealer Association (AADA), in their submission to the PJC Inquiry and other representations to Government have raised issues which are being considered as part of other Government processes or are the subject of ACCC action. These include unfair contract terms, indemnification of dealers for consumer warranty claims and the mandatory information sharing provisions. The PJC Report also made a recommendation for a class exemption to make it lawful for all franchisees to collectively bargain with their franchisor regardless of their size or other characteristic.¹² These matters are highlighted at Box 1 below and are being considered separately as they are governed by different legislation and not the Franchising Code.

3. Background

Business model: car dealerships

¹¹ ACCC 2017, p. 9 (Ibid footnote 1).

¹² Recommendation 14.1, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 202 (Ibid footnote 10).

The main revenue streams for dealers include the new car department, used car department; parts, accessory and aftermarket sales; service workshop sales; and finance and insurance commissions. Estimated gross profit margins from the revenue streams vary but industry estimates place gross profit margins from the new car department at around 7 per cent while gross profit margin from the service department is estimated at around 64 per cent.¹³

Traditionally, motor vehicle dealership agreements were often evergreen with no fixed terms, but over time these agreements have been replaced with fixed term agreements, some of which are as short as 12 months in duration.¹⁴ It has been suggested that on average, around 50 per cent of total dealer margin is now paid in the form of post-facto bonuses tied to a combination of key performance indicators but always with a heavy emphasis on the Consumer Satisfaction Index.¹⁵ Deloitte profit benchmarks suggest that for a profitable dealership, incentive payments are equal to around 20 per cent of gross profit.¹⁶ The AADA has submitted that competitive pressures for new car dealers have increased significantly over time, challenging all aspects of a dealership's revenue streams.

Recent regulatory action by the Australian Securities and Investments Commission to address flex commissions and add on insurance practices has also placed downward pressure on car dealer revenue.¹⁷ Analysis prepared by the advisory firm BDO for the AADA suggests that over time, once the market adjusts, additional revenue will be found to replace the missing finance and insurance income, however, it is not clear whether this will come from increased margins on new vehicle sales or increased incentive based income or another source entirely.¹⁸

What is franchising?

Franchising is a relationship between two separate commercial parties, a franchisor and a franchisee, for a defined term as outlined in their franchise agreement. The franchising relationship is based on a prescribed business model which is offered by the franchisor and carried out under their guidance and oversight by franchise owners (franchisees). For franchisees, the appeal of a franchise is the potential benefits of being able to conduct a

¹³ ACCC 2017, p. 34 (Ibid footnote 1).

¹⁴ Mr Alan Wein, [Review of the Franchising Code of Conduct: Report to the Hon Gary Gray AO MP, Minister for Small Business, and the Hon Bernie Ripoll MP, Parliamentary Secretary for Small Business](#), 30 April 2013, p. 152.

¹⁵ Australian Automotive Dealer Association, [AADA 2017-18 Pre-budget Submission](#), AADA, 19 January 2017, p 4.

¹⁶ Deloitte, [2018 Dealership Benchmarks: Motor Industry Services](#), 2018, pp. 4, 14 and 24.

¹⁷ Acting ASIC Chairman, Peter Kell, [Add-on insurance and flex commission practices](#), Australian Securities & Investments Commissions.

¹⁸ Matthew Cutt, [The Changing Landscape of an Automotive Dealership's Profitability](#), Automotive Dealer Magazine: The Official Publication of the AADA.

business under an established brand name using tested operational systems.¹⁹ In turn, franchisors are able to grow their business by allowing others to use the model they have developed, within an agreement that allows them to retain substantial control over its use but without the financial risks of significant capital expenditure.²⁰

Franchisors are expected to offer an appropriate level of support, guidance and advice to franchisees on using their business model; maintain support through advertising and marketing; provide inputs and equipment of an agreed standard; and update the model when business conditions demand it.²¹ In return, franchisees are expected to pay agreed fees and royalties and execute the business model as prescribed by the franchisor, to a standard that maintains the reputation of the franchise network as a whole.²² The success of a franchise model depends on the provision of a consistent, quality product or service to consumers, who generally view the brand as a homogenous entity and exercise their spending preferences accordingly.²³

The franchising model is necessarily predicated on franchisor control over the use of its brand, allowing it to impose terms and conditions on the way franchisees operate their franchise business.²⁴ Standard form contracts specify the beginning of a franchising relationship but, as allowed for in the contracts, the operations manual and other communications or directions from the franchisor form the basis of daily operations.²⁵

Unlike other commercial relationships, the franchising parties' contractual obligations are variable and based on a symbiotic relationship.²⁶ The obligations do not involve discrete, one-off exchanges between parties on clearly defined terms that characterise ordinary contractual agreements.²⁷ Franchising agreements are drafted to allow flexibility of terms so that the franchise system is able to adapt to constantly changing business conditions.²⁸ Contracts between franchisees and franchisors therefore need continuing cooperation and agreement.²⁹

In line with the Government's Policy Guidelines for Codes of Conduct, the Franchising Code does not seek to restrict competition or unduly interfere with the two commercial parties'

¹⁹ Parliamentary Joint Committee on Corporations and Financial Services 2008, [Opportunity not opportunism: improving conduct in Australian franchising](#), December 2008, pp 5-7.

²⁰ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²¹ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²² Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²³ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²⁴ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²⁵ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²⁶ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19); Federal Chamber of Automotive Industries 2018, Submission to Parliamentary Joint Committee on the operation and effectiveness of the Franchising Code of Conduct, FCAI, May 2018, p. 5.

²⁷ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²⁸ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

²⁹ Parliamentary Joint Committee on Corporations and Financial Services 2008 (Ibid footnote 19).

freedom to contract. Rather, in recognition of the information asymmetry that can exist between franchisors and franchisees, the Franchising Code requires that a disclosure statement be provided to prospective franchisees so they can make a reasonably informed decision about entering into a franchise agreement.

Automotive franchising agreements

Franchising arrangements between car manufacturer franchisors, as represented by distributors within Australia, and Australian car dealerships, as franchisees, are subject to the Franchising Code. However, automotive franchise agreements tend to differ from typical franchise agreements in two key ways:

- New car dealers do not pay fees or royalties to car manufacturers for the use of their brand.³⁰ However, car dealers do make payments to manufacturers for a range of other matters, such as:
 - contributions to co-operative marketing funds;
 - payments for training;
 - payments for services provided (such ICT platforms); and
 - payments for purchasing vehicles, parts, accessories and tools.
- New car dealers often control the location of the franchise and many own the land on which the dealership is located.³¹ In other franchise systems, it is more common for the franchisor to control the location of the franchisee. For example, it is common in other franchise systems for the franchisor to control the lease or own the property.

Box 1: Related Government processes

Franchising Taskforce

In accordance with the PJC Report's first recommendation, an inter-agency Franchising Taskforce (the Taskforce) has been established. The Taskforce is made up of senior officers from the Department of Employment, Skills, Small and Family Business, the Treasury and the Department of the Prime Minister and Cabinet. It is co-chaired by the Department of Employment and the Treasury.

The Taskforce released an Issues Paper on 23 August 2019 for public consultation. The feedback received on the Issues Paper will inform its RIS and advice to Government on its response to the broader recommendations of the PJC Report. The Taskforce is not considering recommendations that are subject to other government processes, including those addressed here relating to franchising in the automotive sector.

³⁰ FCAI 2018, p. 3 (Ibid footnote 26).

³¹ FCAI 2018, p. 4 (Ibid footnote 26).

Collective bargaining

The ACCC proposes to develop a 'class exemption' that would provide legal protection for:

- businesses with an annual turnover of less than \$10 million in the preceding financial year to collectively bargain with customers or suppliers; and
- all franchisees to collectively bargain with their franchisor regardless of their size or other characteristics, without them having to apply to the ACCC.³²

In June 2019, the ACCC released a draft version of the class exemption, and associated documents, for public consultation. The ACCC is considering the results of the consultation with the view to making a final decision about the class exemption.

Supplier indemnification

In its market study, the ACCC identified that dealers were encountering difficulties with claiming the costs associated with remedying manufacturing defects to which they are entitled. The ACCC has taken a range of enforcement actions against car manufacturers to improve their compliance with the ACL and called for manufacturers to review their dealer agreements, policies and procedures to ensure that these commercial arrangements do not contain terms that go beyond what is reasonably necessary to protect their legitimate interests.

At the October 2018 Legislative and Governance Forum on Consumer Affairs (CAF) meeting, Ministers directed officials to undertake work on improving the supplier indemnification provisions in the ACL. This work will go towards ensuring that suppliers are supported by manufacturers in carrying out their refund obligations.

At the August 2019 CAF meeting, Ministers endorsed actions to help ensure suppliers are supported by manufacturers in carrying out their consumer guarantee obligations. Officials will develop an education campaign for business and strengthen guidance material. Ministers also supported a public regulatory impact assessment of proposals to prohibit manufacturers from failing to indemnify suppliers and prohibit retribution by manufacturers against suppliers who seek compensation under the indemnification provisions.

Unfair Contract Terms Review

The Treasury reviewed the unfair contract term protections for small business in late 2018. In light of the findings, the Government has committed to consult on options to strengthen the protections through a Regulation Impact Statement process. One of the options being considered is to broaden the coverage of the protections for businesses. This work may have an impact on the ability of manufacturers to unilaterally vary aspects of the dealership agreement.

³² Collective bargaining class exemption, viewed 27 September 2019 <<https://www.accc.gov.au/public-registers/class-exemptions-register/collective-bargaining-class-exemption>>

The law sets out examples of terms that may be unfair, including: terms that enable one party (but not another) to avoid or limit their obligations under the contract; terms that enable one party (but not another) to terminate the contract; terms that penalise one party (but not another) for breaching or terminating the contract; terms that enable one party (but not another) to vary the terms of the contract. Such contract terms are not prohibited outright. However, if a court or tribunal finds that a term is 'unfair', the term will be void – this means it is not binding on the parties. The rest of the contract will continue to bind the parties to the extent it is capable of operating without the unfair term.

In August 2019, CAF Ministers noted the Government's announcement that it would consult on options to strengthen unfair contract term protection for small business.

4. What is the problem?

In franchising there is typically a power imbalance between franchisees and franchisors, this is also true for dealings between car dealers, as franchisees and car manufacturers, as franchisors, within new car retailing. Motor vehicle dealerships are highly fragmented with many privately owned and operating only a single dealership.³³ The industry has a couple of major players with the Automotive Holdings Group Limited (AHG) and AP Eagers Limited, Australian publicly listed companies, having over \$6 and \$2 billion in revenue in 2017-18 respectively.³⁴ The estimated market shares for AHG and AP Eagers Limited are respectively around 7 per cent and 5 per cent.³⁵ The proposed acquisition of AHG by AP Eagers would result in the merged entity having around 12 per cent market share.³⁶ The AADA in its submission to the PJC Inquiry states that around 85 per cent of dealerships or about 1275 are owned and operated by individuals or are family businesses³⁷, although being a family owned business does not necessarily mean that the business is a small business. The FCAI in its submission to the ACCC on AP Eager Limited's merger application notes 'should the acquisition proceed, it further challenges the notion of a perceived power imbalance between

³³ IBISWorld Industry Report G3911, *Motor Vehicle Dealers in Australia*, April 2018, p. 24.

³⁴ AADA submission to RIS, p. 6.

³⁵ AP Eagers merger application to the ACCC, p. 7, viewed 21 June 2019, <<https://www.accc.gov.au/public-registers/mergers-registers/merger-authorisations-register/ap-eagers-limited-proposed-acquisition-of-automotive-holdings-group-limited>>

³⁶ We note that on 25 July 2019 the ACCC issued a determination granting conditional authorisation of the proposed acquisition for 12 months until 16 August 2020 <<https://www.accc.gov.au/public-registers/mergers-registers/merger-authorisations-register/ap-eagers-limited-proposed-acquisition-of-automotive-holdings-group-limited>>

³⁷ AADA 2018, Inquiry into the operation & effectiveness of the Franchising Code of Conduct, AADA, May 2018, p. 7.

automotive dealers and their suppliers, many of whom are considerably smaller than the two above-mentioned dealer groups.³⁸

During consultation, views differed on the extent to which there is a power imbalance between new car dealers and manufacturers. Manufacturers generally considered that there is no power imbalance, given that dealers are typically large and sophisticated businesses who control access to prime real estate to showcase manufacturers' products. On the other hand, dealers and the ACCC are of the view there is a power imbalance in the favour of manufacturers, given that dealers are presented with agreements on a take or leave it basis, renewal of the agreement is at the discretion of the manufacturer, and that dealers are required to undertake significant capital expenditure, the costs of which may not be able to be recouped during the term of a single agreement.³⁹

Australia has one of the most open and competitive car retailing markets with strong price competition across all levels of the supply chain, wholesaling and retailing, with decreased profit margins over the past five years.⁴⁰

Consultation indicates the Australian new car retailing industry is currently going through a period of significant change, as the sector adapts to the closure of local vehicle manufacturing, changes in technology (such as electric vehicles) and changes in consumer preferences. There has been consolidation in the dealership sector, with larger dealer groups taking over smaller, independent dealers to take advantage of economies of scale. This is expected to continue.

Some car manufacturers have made the decision to reduce their footprint in some areas of Australia, with regional areas particularly affected. Non-renewal⁴¹ (not termination) of dealership agreements in regional areas has meant consumers may not be able to have their car serviced locally or may need to travel further to buy a new car.⁴² While larger players within the industry have been able to benefit through acquiring existing dealerships, these

³⁸ ACCC merger authorisations register, accessed 21 June 2019, <<https://www.accc.gov.au/public-registers/mergers-registers/merger-authorisations-register/ap-eagers-limited-proposed-acquisition-of-automotive-holdings-group-limited>>

³⁹ See AADA, MTAA and ACCC submissions.

⁴⁰ IBISWorld Industry Report, p. 7 (Ibid footnote 33).

⁴¹ This refers to a situation where a manufacturer intends to not extend an agreement or enter into a new agreement following the end of an existing agreement. This does not refer to termination of an agreement which occurs when an agreement is ended by a party prior to the set end date.

⁴² Turnbull, Samantha, MacKenzie, Bruce, Shoebridge, Joanne 2017, [Holden cuts dealership franchises across Australia](#), ABC, 17 August 2017.

acquisitions have tended to occur in larger regional hubs or cities.⁴³ Further background on the new car retailing industry is at Appendix 1.

Franchising power imbalance and new car dealers

A franchisee invests in the business and bears the majority of the risk associated with the operation of a particular outlet, while the franchisor maintains control over the design of the overall system and the quality of the output. There can be an information imbalance since the franchisor has full access to information pertinent to the operation of the entire franchise system and controls its disclosure to franchisees.

In line with the on-going, variable and symbiotic nature of the franchising relationship, the Franchising Code provides that parties to a franchising agreement must act in good faith towards one another.⁴⁴ As such, although car dealers enter into agreements that provide substantial power to the manufacturer, they have a reasonable expectation that the manufacturer will have regard to the legitimate interests of franchisees and the franchise system when exercising their rights under the agreement. It should be noted that while good faith requires a party to have due regard to the rights and interests of the other party, it does not require a party to act in the interests of the other party.⁴⁵ Neither does it prevent either a party from acting in their own legitimate commercial interests.⁴⁶

The good faith obligations are relevant to car dealers who make significant capital outlays on shop fit-outs and equipment towards the end of a franchise agreement. DISER consultations with industry stakeholders, submissions to the 2013 Review of the Franchising Code of Conduct conducted by Mr Alan Wein (Wein Review), and the recent PJC Inquiry indicates dealers generally undertake those investments with the expectation of renewal of the dealership agreement. The extent of this issue occurring has not been quantified, but during consultations there was a view from dealers that this expectation exists.

A decision to not renew a dealer agreement can have a particularly large impact on new car dealers, given the scale of investment required to operate a new car dealership, with estimates provided in the range of \$6 to \$20 million, depending on the size and location of the dealership.⁴⁷ A break down in a franchising relationship can have negative impacts not only

⁴³ AP Eagers, *About Us*, AP Eagers, viewed 19 November 2018, <<https://www.apeagers.com.au/apeagers-company-info/>>

⁴⁴ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, clause 6 (Ibid footnote 9).

⁴⁵ Australian Competition and Consumer Commission, *Acting in good faith*, accessed 21 November 2018 <<https://www.accc.gov.au/business/industry-codes/franchising-code-of-conduct/acting-in-good-faith>>

⁴⁶ ACCC (Ibid footnote 45).

⁴⁷ ACCC 2017, p. 79 (Ibid footnote 1), (note – the ACCC references a February 2017 IBIS World and a submission by Fennessys. The estimates have been confirmed by dealers spoken to in the consultation process).

on the dealer, but also on staff, who may lose their jobs, and consumers, who may no longer be able to return to the dealership to have their car serviced.

Consistent anecdotal evidence indicates there are three main problems in the context of dealer agreements – negotiating end of term arrangements, the capacity to recoup capital expenditure and dispute resolution.⁴⁸ An important factor that drives these problems in the new car retailing industry is the significant upfront capital investment involved in establishing new dealership facilities and the value of stock holdings.

End of term arrangements

Under the Franchising Code, a franchisor must provide at least six months' notice if it intends to not renew the agreement. Given the scale of investment involved in establishing a dealership, 12 months' notice is suggested by dealer representatives (and recommended in the PJC Report⁴⁹) as a more adequate period of notice⁵⁰ for a car dealer to manage the non-renewal of its agreement. For example, a longer notice period may assist dealers to repurpose facilities, find an alternate franchise, or manage down its stock levels⁵¹. Statistics on the number of agreements not being renewed have not been provided to DISER, however media reporting of Holden's decision to not renew up to 30 dealer agreements in 2018 suggests that not renewing 30 agreements is not a regular occurrence and tends to be precipitated by strategic reviews undertaken by car manufacturers. Further, we heard anecdotally during consultations that the number of dealer agreements not renewed annually is low (noting there are over 1500 car dealers in Australia).⁵² DISER's consultation confirms this. Buy-sells, where the dealer sells the business to another entity subject to approval by the manufacturer, tend to be more common and vary depending on the brand, with larger brands noting less than 10 buy-sells annually. However, whilst the number of agreements not renewed may be low, the impact on those dealers whose agreements are not renewed can be significant. There are also significant impacts within regional areas where dealerships contribute to employment and ensure consumers' access to local services.

⁴⁸ We note that there are 72 car brands in the Australian market and there is no single common data collection point for details about commercial contracts. The broad spread of brands in the market (and the sensitivity inherent in commercial arrangements) creates difficulties in quantifying the occurrence of the problems identified in this RIS. However, we note that when these problems do arise (as shown in the anecdotal evidence) the effects on the dealer and the community (particularly in regional areas) can be significant and require addressing.

⁴⁹ Recommendation 17.1, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 234 (Ibid footnote 10).

⁵⁰ AADA 2018, p. 4 (Ibid footnote 37); Motor Trades Association of Australia 2018, *MTAA Limited Submission to the Parliamentary Joint Committee on Corporations and Financial Services on the operation and effectiveness of the Franchising Code of Conduct*, May, MTAA, p 19.

⁵¹ For more detailed discussion regarding purchasing arrangements for stock, tools and equipment, please see discussion at Options 2A and Option 2C.

⁵² Turnbull, Samantha; MacKenzie, Bruce; Shoebridge, Joanne (Ibid footnote 42); AADA 2018, p. 3 (Ibid footnote 37).

Feedback provided during consultation varied in relation to whether dealers have prior knowledge of the intent to not renew an agreement. Manufacturers indicated that non-renewals take place over a long period and the issuance of a non-renewal notice would not be a surprise. On the other hand, dealers (including those who have been issued non-renewal notices) consider that the issuance of a non-renewal notice typically is a surprise to the dealer and is not an event that is planned for.

Unlike termination for breach, a manufacturer is not required by the Franchising Code to provide a dealer with reasons for issuing a non-renewal notice. Non-renewal without cause is of particular concern for dealers who have undertaken capital expenditure towards the end of a franchise agreement. Non-renewal without being provided a reason makes it more difficult for a dealer to assess whether the manufacturer has exercised its right to issue a non-renewal notice in good faith, as required by the Franchising Code.

Capital expenditure

The Franchising Code places restrictions on when a franchisor can require a franchisee to undertake significant capital expenditure. Capital expenditure can only be required of franchisees if:

- it is disclosed through the regular disclosure process prior to agreement;
- if it is agreed to, or approved by, the majority of franchisees;
- the expenditure is required to comply with legal obligations;
- it is agreed to by the franchisee; or
- the franchisor considers the expenditure necessary and can be justified by a rationale for the investment, an explanation of the amount of the expenditure, the anticipated outcomes and benefits and the expected risks for making the investment.

Dealers' concerns with disclosure of capital expenditure is twofold. Firstly, as noted by the ACCC in its submission to the PJC Inquiry⁵³, franchisors typically disclose very broad ranges of estimated significant capital expenditure. This is problematic because the costs of upgrading a facility in a metropolitan area compared with a rural area can vary considerably.

Secondly, as noted in the AADA's submissions, dealers have a propensity to accede to car manufacturers' request to undertake capital expenditure even if there is doubt as to whether that outlay can be recouped during the term of a dealership agreement because of an expectation that the dealer may be offered another term. This expectation may also arise given

⁵³ Australian Competition and Consumer Commission, *Inquiry into the operation and effectiveness of the Franchising Code of Conduct: ACCC Submission*, ACCC, p. 9.

the relational and ongoing nature of the franchising relationship. The ACCC in its submission to the Wein Review outlined a scenario where a franchisee may undertake an expensive shop fit-out towards the end of a dealership agreement in the expectation of renewal but the agreement is then not renewed.⁵⁴ While there are existing provisions within the CCA to which the franchisee may have recourse, such as unconscionable conduct, pursuing a remedy through dispute resolution or litigation can be expensive.

Dispute resolution

The Franchising Code enables either party to an agreement to initiate mediation, which is an informal dispute resolution mechanism. While this mechanism is available, some dealers are hesitant to utilise these provisions for fear of commercial retaliation by car manufacturers. For example, the Office of the NSW Small Business Commissioner (OSBC)⁵⁵, has stated that

'[f]ear of retaliatory action has been cited...by many dealers as a deterrent in proceeding to formalise their complaints and seek remedies for unfair contracts and unjust conduct in relation to manufacturers' supply contracts under the' *Motor Dealers and Repairers Act 2013* (NSW) (MDRA).

This fear would similarly apply to dispute resolution processes under the Franchising Code.

At present, multi-franchisee mediation is possible under the Franchising Code with the agreement of the franchisor – unless this would be seen to be anti-competitive. However, the Franchising Code does not expressly state that multi-franchisee mediation can be undertaken when disputes of a similar nature arise within a franchise system. A lack of an express statement within the Franchising Code allowing multi-franchisee mediation could be limiting car dealers' ability to collectively initiate mediation with car manufacturers. Multi-franchisee mediation may limit the impacts of the power imbalance between dealers and manufacturers by allowing dealers to join their resources and build confidence in numbers. The ACCC in its feedback on this RIS proposal also referred DISER to its proposal to develop a 'class exemption' that would provide legal protection for collective bargaining by franchisees with their franchisor and businesses with an annual turnover of less than \$10 million in the preceding financial year to collectively bargain with customers or suppliers on common issues.⁵⁶ The RIS proposal for multi-franchisee mediation complements the ACCC's class exemption. During its consultation DISER received feedback that multi-franchisee dispute

⁵⁴ Australian Competition and Consumer Commission 2013, [2013 Review of the Franchising Code of Conduct: Supplementary information to ACCC submission](#), 8 March 2013, p. 2.

⁵⁵ Office of the NSW Small Business Commissioner 2016, [Submission to the ACCC's October 2016 New Car Retailing Industry Market Study \(Issues Paper\)](#), OSBC, 22 November 2016, p. 1.

⁵⁶ ACCC (Ibid footnote 32).

resolution has assisted parties to reach settlements in the new car retailing industry. The PJC Report also supported expressly providing for multi-franchisee mediation.⁵⁷ In particular, the PJC recommended that the dispute resolution scheme under the Franchising Code remain mandatory and be enhanced to include the capacity for a mediator to undertake multi-franchisee resolutions when disputes relating to similar issues arise.

5. Why is Government Action needed?

Existing coverage of motor vehicle dealers by franchising regulation

The operation of the franchising sector and the high level of disputation between the parties to a franchise agreement has been a concern for successive Governments since the mid-1970's. The Franchising Australia 2016 Report suggests that 25 percent of franchisors are involved in a dispute with their franchisee/s.⁵⁸

In 1998, the Government introduced the Franchising Code of Conduct as a mandatory code, enforceable under the then *Trade Practices Act 1974* (now the *Competition and Consumer Act 2010*). In introducing the Franchising Code, it was noted that the high levels of disputation and litigation in the sector arise from the fundamental nature of franchising arrangements, which differ significantly from other business ventures. As discussed above, the nature of franchising means that the power imbalance favours the franchisor, as does the information asymmetry.

While some common features of franchising may be missing within automotive franchising, such as payment of royalties, motor vehicle dealers are covered by the Franchising Code since it is recognised that dealership agreements and the relationship between dealers and car manufacturers were characterised by other features common within franchising, namely the power imbalance and information asymmetry which favours franchisors.⁵⁹

Car manufacturers are able to stipulate capital outlays, for example shop fit-out requirements and equipment to be held by car dealers. In addition, there are information asymmetries between car manufacturers and new car dealers with car manufacturers typically holding greater information about the long term strategy for the brand and the overall health of the

⁵⁷ Recommendation 15.2, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 217 (Ibid footnote 10).

⁵⁸ Frazer, Lorelle, Weaven, Scott, Grace, Anthony, Selvanathan, Selva, [Franchising Australia 2016](#), p. 7.

⁵⁹ See the House Standing Committee on Industry, Science and Resources, *Finding a balance: Towards fair trading in Australia*, May 1997.

entire dealer network. For example, an individual dealer may consider that its performance is sound, but from the manufacturer's perspective, the dealer may be the weakest link in the market and may require downsizing in order to ensure the health of the overall network. This information asymmetry can have adverse effects on dealers, particularly when they undertake significant capital expenditure, such as purpose built facilities to showcase cars in line with the manufacturer's preference.

Ongoing issues for car dealers

Although it has been a longstanding intent of the Franchising Code to address issues in automotive franchising, many of the problems identified within the 1997 Report are recurrent in subsequent inquiries. The Wein Review specifically canvassed franchising issues for automotive dealers and recommended an analysis of the impact of a minimum term and standard contractual terms for motor vehicle agreements prior to a future review of the Franchising Code. The ACCC in its market study also recommended issues raised by dealers relating to the imbalance of power in their commercial arrangements with manufacturers, such as insecure tenure and significant capital outlays expected of dealers, be examined further. The recent PJC Report also examined franchising issues experienced by new car dealers and made two recommendations directed at automotive franchising.

Stakeholders consider the Franchising Code requires additional consideration for the new car retailing sector. The high-value products supplied by new car dealers, commonly representing the second largest outlay and ongoing expense for a household apart from housing costs, along with the high outlay of capital by dealers to showcase car manufacturers' products is unique to the sector. The large portion of franchisees are small retail outlets who provide fast moving consumable goods. The Franchising Code is designed to suit these types of businesses. In most franchise arrangements, the franchisor has very close control over the operation of their franchisees with goods, services and staffing levels identical between sites. This is not always the case with car dealerships and the power imbalance can vary depending on the circumstances.

The limitations of the Franchising Code have in some instances, resulted in car dealers being provided with insufficient notice when an agreement is not being renewed and inadequate capital expenditure disclosure. Whilst these issues do not arise in most instances, where they do occur, the impact on the dealer can be considerable.

For example, during consultation DISER heard experiences where some stakeholders were provided with a notice of non-renewal and incurred significant business losses. Some dealers were able to mitigate their losses by opening new dealerships with a different brand on the

same site or open new businesses. However, significant costs were still incurred in the redevelopment and not all sites were able to be repurposed. The measures that are detailed below in this RIS, such as extending the notice period and requiring parties to discuss and agree to a plan to wind down the business, may assist in mitigating any disadvantage to the dealer whilst balancing the need of the manufacturer in maintaining control of its network.

Objective in implementing the RIS reforms

The overarching objective in implementing these reforms is to support appropriate commercial dealing and competition in the new car retail supply chain.

What will success look like?

The proposal will have succeeded if:

- there are improved and reciprocal practices when agreements are not renewed;
- clear reasons and grounds are provided for non-renewal of agreements;
- there is sufficient flexibility in commercial dealings for future challenges (for example, industry's ability to adapt to technological advancements and changing business models);
- there is a more equitable power balance between dealers and manufacturers, particularly in relation to capital expenditure disclosure; and
- parties are aware of and make increased use of multiple-franchisee mediation mechanisms.

6. Options

1 – Status Quo

Under this option, no regulatory changes would be made and new car dealers and car manufacturers would continue to be subject to the existing provisions in the Franchising Code (which are summarised in Appendix 2). If any amendments were made to the Franchising Code in response to the PJC Report, those amendments could also apply to dealer agreements.

The PJC Report made several recommendations for the broader franchising sector as well as specifically for the automotive sector. While some of these recommendations address concerns raised by new car dealers, they do not address the full range of concerns. For example, the RIS recommends requiring reasons for non-renewal, in the case of a dealer receiving the notice, to allow a better assessment of their options. Without further action car

dealers could continue to face problems negotiating end of term arrangements, in gaining meaningful disclosure on, and recouping, capital expenditure.

Net benefits

While this option could have no regulatory impact, it is not the preferred option as it would not address the problems identified in this RIS.

2 – Regulatory Intervention

Under this option, the Government would make regulatory changes to address the issues identified in the problem section of the RIS. The reforms could be implemented by amending the Franchising Code to incorporate additional obligations which only apply to dealership agreements. This chapter includes a number of sub-options, each of which are considered individually, but if chosen, could be implemented as a group of amendments.

Regulatory burden

Total Option 2 Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	Nil			Nil

The above 'Nil' costing reflects that the changes to the Franchising Code of Conduct, proposed by this RIS, are not expected to extend beyond what are included in the Options below, and thereby costed, in the regulatory options.

Option 2A – 12 month notice periods

Under the Franchising Code, if a franchisee intends to not renew the agreement they must provide the franchisee notice of their intention to not renew at least six months prior to the end of the agreement.

To provide new car dealers with more time to consider how to manage their affairs at the end of their agreement, this option, as supported in the PJC Report⁶⁰, would require 12 months' notice be provided, rather than six months. The new obligation would only apply to an agreement with a term greater than 12 months. The obligation would also apply to car dealers, to provide manufacturers with time to find a new car dealer in a particular area.

⁶⁰ Recommendation 17.1, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 234 (Ibid footnote 10).

When the non-renewal notice is given, the manufacturer and the dealer would be required to develop and agree a plan, with milestones, to end their agreement. This would include how stock levels (including new vehicles, spare parts and service and repair equipment) will be managed after the non-renewal notice is issued. An obligation would also be placed on both parties to work co-operatively to reduce stock holdings as the agreement draws to an end.

Consultation feedback indicated some dealers are subject to targets for the level of stock holdings set by the manufacturer. A longer notice period and an obligation to work cooperatively could provide dealers with an opportunity to reduce the costs associated with large stock holding when the agreement ends.

Feedback provided by manufacturers during the consultation process indicated that generally manufacturers would provide more than six months' notice. The feedback indicated some manufacturers begin discussions 18 months prior to the end of an agreement, though nine to 12 months was more common.

In addition, though not always the case, consultation indicated manufacturers generally work with dealers to co-operatively manage stock levels after a non-renewal notice is issued because it is in both parties' interest to avoid a fire sale of excess stock by the dealer at the end of an agreement potentially resulting in brand damage and devaluation of existing customers' cars. As such, this element of Option 2A is consistent with industry best practice. The notice period could be shortened by mutual agreement of the parties. For example, both parties could mutually agree to end their relationship in 90 days instead of waiting 12 months.

Impact on car dealers

Requiring longer notice periods for non-renewal would provide car dealers with more time to arrange their affairs in the event their agreement is not renewed. For example, it would provide dealers with additional time to:

- search for a new franchisor;
- sell the site; or
- where they operate multi-franchise arrangements, re-configure their site to focus on their remaining brands after the agreement expires.

It could also provide staff opportunities to look for alternative sources of employment and provide time for consumers to make alternate arrangements for servicing if relevant. While staff might be able to benefit from being able to find alternative employment, both dealers and manufacturers noted concerns that a longer notice period might result in a faster loss of service staff which is why this option allows shorter notice periods to be negotiated by parties.

Having longer notice periods may also reduce the likelihood that dealers will agree to undertake capital expenditure that they are unable to recoup, as a car dealer is unlikely to undertake capital expenditure during the 12 month period where they know the agreement will not be renewed. Alternatively, where a dealer decides upon receiving the notice of non-renewal to switch to another franchise at the end of the agreement, they may be able to undertake the capital expenditure in a way that means that the new facilities can be more easily re-purposed to be used for another brand.

More broadly, even if an agreement is eventually renewed, the uncertainty inherent in short notice periods for non-renewal could affect the decision making of new car dealers in running their business. For example, a car dealer may choose to invest further in the business if it has certainty that the car manufacturer will not issue a non-renewal notice six months after a major outlay of capital.

Recognising that both parties play a role in reducing the level of new vehicle stock that dealers hold at the end of an agreement, this option would require both parties to co-operate to appropriately manage stock in a way that is fair to both the manufacturer and the dealer.

Impact on manufacturers

Having longer notice periods will require manufacturers to communicate decisions regarding whether to renew an agreement earlier, potentially reducing their flexibility to not renew an agreement. Manufacturers may also find it more difficult to require a dealer to undertake capital expenditure during the period between 12 months and six months out from the end of the agreement when they intend not to renew the agreement. Manufacturers would still retain the right to renew, or not renew, an agreement.

However, most manufacturers indicated as part of the consultation process that the non-renewal process would generally take place over an extended period of time and ordinarily around 12 months' notice would be given when an agreement is not renewed. As a result mandating a 12 months' notice period is not expected to create a significant obligation above what is currently considered to be best practice.

Requiring dealers to provide 12 months' notice of an intention to not continue in the agreement would provide manufacturers with time to find another dealer if they wish to maintain a presence in a particular area.

Manufacturers will also be required to work co-operatively with dealers to manage stock as an agreement draws to an end to meet the needs of both parties and allow them to balance the

requirement of meeting customer needs with avoiding a dealer holding very high levels of stock at the end of an agreement.

Net benefit

Consultation indicates current arrangements in place to manage unsold parts and service and repair equipment generally work well. However, there are differing views on the effectiveness of current arrangements for the treatment of remaining new vehicle stock. Dealers consider that manufacturers are ‘dumping’ stock on dealers at the end of agreements and that dealers have little say over how much stock they hold.⁶¹ In contrast, manufacturers claim that dealers are responsible for ordering stock and that they can run down their stock holdings as an agreement draws to an end.

Requiring both parties to develop a plan and work co-operatively to wind down stock levels as the agreement draws to an end will help to ensure the risk is shared.

This option could provide car dealers with additional certainty and, where an agreement is not being renewed, provide them with more time to prepare for the end of the agreement. Whilst car manufacturers would have less flexibility and have to communicate decisions earlier, they still retain the right not to renew an agreement. The cost incurred by new car dealers, in terms of winding down a business or negotiating a new dealership agreement (particularly if there is a gap between agreements), could outweigh the business costs incurred by car manufacturers. Both car dealers and car manufacturers generally support the introduction of 12 month notice periods. As such, this option is expected to have a positive net benefit.

Regulatory burden

Total Option 2A Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	\$2.46			\$2.46

Regulatory burden would be incurred by manufacturers and dealers who would need to draft a business plan after the non-renewal notice is issued and send staff to attend a meeting to discuss the plan.

The regulatory burden calculation assumes it would take a staff member from the manufacturer and dealership four weeks to jointly prepare a plan. It is also assumed that two

⁶¹ See MTAA submission to RIS, p. 16.

staff from the dealership and from the manufacturer would attend a two hour meeting to discuss the plan. It is assumed that all of these staff would earn \$500 per hour. This cost would be incurred each time an agreement is not renewed and it is assumed that 15 agreements are not renewed each year.

The quantitative benefits should exceed the regulatory burden of \$2.46 million to justify implementing this option. To assess whether this is realistic, several assumptions have been made. It is assumed that the average dealership has around \$2.1 million in stock and equipment remaining at the end of an agreement;⁶² and that 15 agreements are not renewed each year. Thus, total stock for the 15 dealers is almost \$32 million. Dividing the regulatory burden cost by the stock value suggests that an 8 per cent improved outcome on the management of stock would create a positive net benefit.⁶³ To put this another way, each dealership that is not renewed would have to reduce its stock liabilities by about \$200,000 compared with existing liabilities on implementation of this option for it to be considered to have a positive net benefit. It is reasonable to expect this outcome could be achieved by developing a co-operative strategy for winding up a dealership agreement.

It could also be argued that some of the 15 agreements which are not renewed could be settled in a manner similar to how the option proposes, that is, working co-operatively to develop a plan and giving 12 months' notice. If that is the case, then the regulatory burden could decrease proportionally, resulting only in a marginally larger return required for the remaining dealers.

Option 2B – Reasons for non-renewal

Unlike termination for breach, a manufacturer is not required by the Franchising Code to provide a dealer with reasons for issuing a non-renewal notice. To support the existing obligation for parties to act in good faith, this option would require the party that is not renewing an agreement to provide a statement of reasons to the other party explaining their decision.

Impact on car dealers

This option could make it easier for a dealer to assess whether the manufacturer has exercised its right to issue a non-renewal notice in good faith, with a duty of good faith being an existing requirement under the Franchising Code.

⁶² Estimate based on new car sales data provided by FCAI, industry stakeholder estimates of 65 as the average number of days new car stock is held and 3500 dealerships.

⁶³ 2.46 million /31.6 million = 8%

While this option by itself would not address the other issues faced by dealers upon non-renewal, such as organising their affairs and looking for alternative dealership agreements, it could be conducive to building a better dialogue between the parties to the franchise agreement to enable dispute resolution on end of term arrangements.

During consultation, car dealers were generally supportive of this option.

Impact on manufacturers

This option could hold manufacturers to greater legal account of their decision to not renew franchise agreements, which may lead them to incur compliance costs if they are found to be acting contrary to their legal obligations. However, providing reasons may also benefit them if it results in speedier dispute resolution through a better dialogue with their franchisees. Some manufacturers noted they will need to give careful consideration to the exact nature of information provided as part of their statement of reasons to ensure that commercial in-confidence information is not revealed.

This option would place reciprocal obligations on dealers so manufacturers would get useful feedback as to why a dealer is not renewing an agreement, when the dealer decides to end the relationship with the manufacturer. At present there is no minimum notice period that needs to be provided by a dealers to a manufacturer under the Franchising Code when a dealer decides to relinquish an agreement, which can take place at any time during the term of an agreement.

During consultation, car manufacturers were generally supportive of this option.

Net benefit

This option could provide car dealers and manufacturers with additional certainty about good faith dealings by their franchisors and could assist with dispute resolution where an agreement is not being renewed. Car manufacturers could be held to greater legal account and would need to take time, and incur costs, to provide reasons for non-renewal. However, a manufacturer retains the right not to renew a contract, and the benefit to the car dealer in gaining assurance that the car manufacturer has exercised its decision in good faith could likely outweigh the possible detriment to the manufacturer. Both car dealers and manufacturers generally supported this option and during the consultation, it was suggested that manufacturers are doing this currently, though less formally. As such, this option is expected to have a positive net benefit.

Regulatory burden

Total Option 2B Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	\$0.015			\$0.015

Regulatory burden would be incurred by manufacturers and dealers who would need to allocate time and communicate through writing to the other party on reasons for non-renewal.

The regulatory burden calculation assumes that:

- 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; and
- that 15 agreements are not renewed.

Quantifying the benefit is difficult. However, it is noted that the actions taken by dealers currently to ascertain the reasons for non-renewal would simply have to exceed \$1000 per firm to justify implementing this option. This could be met by any number of actions by the dealers, including simply making an effort to ascertain this information from the manufacturer. For this reason, this option is determined to be beneficial.

Option 2C – Stock buy-backs

Under this option dealer agreements would be required to include a stock buy-back provision in the context of non-renewal of dealer agreements. The provision would provide the price of the stock would, in the first instance, be agreed between the manufacturer and the new car dealer. It is intended that the price of the stock would be negotiated by the parties after the notice of non-renewal is served. Noting that parties would still be obliged to act in good faith during negotiations. If an agreed price cannot be reached, then the value will be determined by an independent valuer, appointed by the parties.

The PJC Report recommended that it be mandated that the ‘franchisor buy-back at cost price all vehicle parts up to three years old, with the cost of any independent valuation of stock to be split evenly between the franchisor and franchisee.’⁶⁴

Currently, the Franchising Code does not specify the end of term arrangements that should apply between dealers and car manufacturers. In line with the general principles of contract

⁶⁴ Recommendation 17.1, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 234 (Ibid footnote 10).

law, the Franchising Code allows distributors and dealers to negotiate terms that best suit their circumstances. This includes making provisions for the buy-back of stock.

Some existing dealer agreements do require manufacturers to buy back stock when an agreement expires or terminates, however, not all agreements contain these provisions. According to the AADA, typically the manufacturer has discretion as to whether these buy back provisions are exercised.⁶⁵ As discussed above in relation to end of term negotiations and notice periods, while industry practice varies, both parties can work together to reduce stock levels as an agreement draws to an end so the implications of buy-back provisions will also tend to vary accordingly.

Feedback received during consultation regarding car dealers' ability to control their stock levels as an agreement draws to an end varies. Manufacturers set targets, which often involve levels of stock, which car dealers need to meet in order to receive incentive payments. Dealers can also be contractually obliged to hold certain levels of stock.

Floorplan or bailment financing arrangements are typically used by dealerships which involve dealers taking possession, but not ownership of showroom vehicles and the financier retains ownership of the motor vehicle until sold. Dealers can be subject to an 'automatic release floor plan facility' where they have to accept stock as it is received. However, in some circumstances dealers can also manually determine how much stock they order.

Impact on car dealers

This option could reduce the costs to car dealers of an agreement expiring, potentially increasing their bargaining power with manufacturers.

For example, the MTAA⁶⁶ asserts that, even when amicable, end of contract events can result in significant disadvantage to new car dealers which impact closing profits across new car dealership operations. Aside from its vehicles, the MTAA⁶⁷ noted that a dealer may have over a million dollars of parts in stock, which are needed for: counter sales to members of the public; account sales (to, for example, independent repairers); and workshop/service stock. The MTAA⁶⁸ also identifies that larger dealerships typically will have much larger stock holdings, and may also supply parts to smaller dealerships.

⁶⁵ AADA 2017, [Australian Automotive Dealer Association submission to the ACCC issues paper](#), AADA, 19 October 2017, p. 3.

⁶⁶ MTAA 2018, p. 18 (Ibid footnote 50).

⁶⁷ MTAA 2018, p. 18 (Ibid footnote 50).

⁶⁸ MTAA 2018, p. 18 (Ibid footnote 50).

The MTAA⁶⁹ also explained that in the servicing area of the business, the dealer is required to purchase a range of specialist equipment and tools as specified by the car manufacturer. In particular, car dealers in regional areas will be affected as many may not need to use the specialist equipment due to the type of cars typically sold in those areas.⁷⁰ As these tools are owned by the dealer, they are usually not part of end of term arrangements.⁷¹

Impact on car manufacturers

Mandating stock buy-backs could shift the risk of there being excess stock remaining at the end of an agreement.

Car manufacturers indicated during consultation that they generally work with dealers to manage stock levels at the end of an agreement to avoid fire sales of new vehicles. As such, mandating stock buy-backs is only likely to have a significant impact on manufacturers that do not adhere to this practice.

While there would be costs associated with buying back stock, this would be partly offset by manufacturers' ability to re-sell the stock. Given that the majority of the stock would be new vehicles that have not yet been driven, if the manufacturer were to re-purchase the stock at the price paid by the dealer, they could likely be able to sell the stock for a similar price to another dealership or to fleet buyers though this could depend on the length of time the vehicle had been held by the dealer. The manufacturer could also incur costs associated with storing and transporting the vehicles.

In regards to buying back parts, as recommended in the PJC Report, the cost to the manufacturer could again be partly offset by the manufacturers' ability to re-sell the stock. However, if the manufacturer were to purchase parts up to three years old at cost price they may be unable to sell the parts or recoup the price of the parts at a similar price due to the devaluing of parts overtime. As the retailer, it is the dealer who has the community connections to the public and other business (for example, independent repairers) to more readily sell the parts and mitigate loss.

Net benefit

This option would provide manufacturers with an incentive to work with dealers to appropriately manage stock. However, it would not provide dealers' with an incentive to appropriately manage stock, as they would know that the manufacturer will simply buy back

⁶⁹ MTAA 2018, p. 18 (Ibid footnote 50).

⁷⁰ MTAA 2018, p. 18 (Ibid footnote 50).

⁷¹ MTAA 2018, p. 18 (Ibid footnote 50).

the stock if they order an excessive amount of vehicles, although they would still be responsible for meeting the costs of holding the stock.

During consultation car manufacturers also indicated that in some cases they work proactively with dealers to manage stock and they would buy back vehicles even where there are no buy back provisions in the contract.

Without specific provisions in agreements for buy-backs, the risks associated with there being excess new car stock at the end of an agreement primarily rest with the dealer. This option would shift that risk to the manufacturer. Given that both parties should play a role in determining the level of stock that a dealer holds as an agreement draws to an end, Option 2A, which would require both parties to work co-operatively to wind down stock levels when a non-renewal notice is issued, is the preferred option.

Regulatory burden

Total Option 2C Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	\$31.6			\$31.6

Regulatory burden would be incurred by car manufacturers who would be required to buy back stock they would not otherwise be required to purchase. In practice, some of this burden could be offset to the extent that the manufacturer is able to re-sell the stock it has bought from the dealer. This offset has not been included when calculating the regulatory burden.

The regulatory burden calculation assumes that:

- the average dealership has around \$2.1 million in stock and equipment remaining at the end of an agreement;⁷² and
- that 15 agreements are not renewed each year.

In determining whether this is a quantitatively beneficial option, it is worth noting that effectively, the benefit to the dealer balances out the cost to the manufacturer. Thus, the argument to support or reject this option does not arise from a cost-benefit argument. Rather, it comes down to the arguments presented earlier, which suggests that placing an obligation on either party to be responsible for the stock at the end of the agreement should not be

⁷² Estimate based on new car sales data provided by FCAI, industry stakeholder estimates of 65 as the average number of days new car stock is held and 3500 dealerships.

predetermined between parties. And as discussed elsewhere, preferentially the management of stock at the end of an agreement should be done in a co-operative manner.

Option 2D – Enhanced capital expenditure disclosure

Under the Franchising Code, a franchisor is only able to require a franchisee to undertake significant capital expenditure in limited circumstances. One of those circumstances is where the expenditure was disclosed prior to entering into the franchise agreement (see Appendix 2 for a complete list of circumstances). DISER has heard that some manufacturers can disclose extreme ranges of capital expenditure that may be required (for example, \$50 thousand to \$50 million in establishment costs), making the disclosure effectively meaningless.

The PJC Report recommended dealers not be compelled to upgrade the dealership after notice of non-renewal or termination has been given to the dealer.⁷³ During consultation, DISER heard that rather than being compelled to upgrade the dealership after a notice of non-renewal was provided, a dealer was being compelled to upgrade a dealership prior to a notice being provided. This change in timing means that in the first scenario, a dealer could be able to assess whether or not to undertake the capital expenditure in light of the non-renewal. Whereas in the latter scenario the dealer is unaware of the non-renewal and therefore more likely to feel compelled to undertake the capital expenditure for fear of non-renewal.

To address this concern this option proposes automotive franchisors would only be able to require significant capital expenditure to be undertaken when that expenditure is disclosed with a high degree of specificity regarding the timing and nature of the expenditure and consideration of ability to recoup. This would require the manufacturer to disclose any relevant information they have, such as indicative per square metre costs for building materials, an overview of the type of upgrades that will be required, or plans to significantly change the corporate identity of the brand during the term of the agreement. The disclosure would also need to be tailored either to the dealer or to similar groups of dealers (such as metro or rural dealers).

During consultation manufacturers indicated that while they often know the types of upgrades they will require the dealer to undertake, the precise costs are not known as it is the dealer who engages the builder and who has the best information about the size and layout of their dealership. This option would not require a manufacturer to precisely disclose information that they do not have, but would require them to disclose relevant information, such as the nature of the potential upgrades.

⁷³ Recommendation 17.1, Parliamentary Joint Committee on Corporations and Financial Services 2019, p. 234 (Ibid footnote 10).

The manufacturer and the dealer would be required to meet and discuss the disclosure, including under what circumstances the dealer is likely to recoup the costs of their investment and their prime market areas. This is not intended to provide the dealer a guarantee that they will recoup their costs, as there is always an element of risk inherent in any commercial decision. This option will provide dealers with more precise disclosure so they can make a clearer assessment of whether they are able to recoup the size of their capital outlay during the term offered.

Manufacturers would also be unable to force a dealer to undertake any significant capital investment apart from that which is disclosed prior to entry into the agreement. It will act as a limitation on further expenditure that can be required of dealers following a significant capital outlay. Dealers could still undertake significant capital investment where both parties mutually agree that it would be beneficial to do so part way through the agreement, where expenditure is to be incurred by all or a majority of franchisees – expenditure approved by a majority of those franchisees, or where expenditure is incurred by the franchisee to comply with legislative obligations.

As discussed above, there exists an information asymmetry between car manufacturers and new car dealers with car manufacturers typically holding greater information about the long term strategy for the brand and the overall health of the entire dealer network. This information asymmetry has resulted in a market failure leading to sub-optimal outcomes for car dealers, particularly when they undertake significant capital expenditure, such as purpose built facilities to showcase cars in line with the manufacturers' preference. Disclosure of capital expenditure is not specific enough and there is insufficient regard for capital outlays undertaken by dealers which cannot be recouped during the term of the existing dealership agreement.

It is acknowledged that this measure does not remove the potential for manufacturers to exert pressure on dealers. However, it provides additional transparency to assist the market to operate efficiently and enables dealers to make a clearer assessment of whether the manufacturer is acting in good faith when requesting capital investments, thereby assisting the dealer in assessing their commercial and legal options.

Impact on car dealers

Short and uncertain tenure and poor disclosure practices provide manufacturers with the ability to apply commercial pressure to new car dealers to incur significant capital expenditure

in the form of refurbishments, building new premises or relocating premises, the costs of which may not be able to be recouped during the life of the agreement.

Limiting car manufacturers' ability to require a dealer to undertake significant capital expenditure unless disclosed prior to entering into the arrangement with greater specificity and agreed to by the dealer will help to ensure that dealers only undertake capital expenditure that they consider to be in their interests. It will also encourage manufacturers to work with their dealer networks to develop capital expenditure plans that both parties support. During consultation manufacturers indicated they work with dealers on capital investment plans over a long period and that in order for investment to be undertaken, both parties need to agree that it is mutually beneficial to do so.

Impact on manufacturers

Manufacturers would have reduced flexibility and requiring car dealers to undertake significant capital expenditure and would require better planning, as they will have to provide more detail regarding the capital expenditure than is currently the case. Under this option, manufacturers may need to plan significant capital expenditure programs either well in advance (so that they can be included in the relevant disclosure material) or in a way that gains dealers support for the proposed expenditure.

Importantly, as currently allowed under the Franchising Code, even where the expenditure is not disclosed, manufacturers would still be able to require significant capital expenditure to be undertaken where the expenditure will be incurred by a majority of franchisees and a majority of franchisees approve the expense. As such, a minority group of dealers will not be able to prevent expenditure that has the support of the majority of the dealer network.

Net benefit

This option could benefit car dealers by reducing the likelihood that they will be required to incur significant capital expenditure for which they have not planned. While manufacturers would find it more difficult to compel dealers to undertake significant capital expenditure through prior disclosure, they would still have a number of avenues to do so:

- the manufacturer could gain the dealer's support for the expenditure;
- the manufacturer could include the detailed disclosure when the agreement is renewed and require the expenditure to be undertaken early in the agreement; or
- if all franchisees are being required to undertake the expenditure, the manufacturer could seek to gain the support of the majority of franchisees.

Given that this option could benefit dealers but still provide a range of mechanisms via which manufacturers can require significant capital expenditure to be undertaken that they consider necessary, this option is likely to have a positive net benefit.

Regulatory burden

Total Option 2D Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	\$2.1			\$2.1

Regulatory burden would be incurred by firms as new terms in dealership agreements would need to be drafted when dealership agreements are renewed. Costs would also be incurred by the staff who would attend the meeting to discuss the significant capital expenditure disclosure. The regulatory impact would be incurred each time a dealer agreement is renewed, as required capital expenditure is likely to vary for each agreement.

The regulatory burden calculation assumes that:

- it would take a lawyer two hours to draft the capital expenditure disclosure part of an agreement each time an agreement is renewed (twice over 10 year period) at a cost of \$500 per hour;
- that on average dealership agreements last for five years (so all 3500 agreements would need to be renewed twice over a 10 year period); and
- that two staff members would attend a one hour meeting from the dealership and the manufacturer (which would occur twice over a 10 year period).

For there to be a quantitative benefit, the 3500 dealerships would need to benefit by more than \$2.1 million a year, or \$10.5 million over the course of the agreement. This implies that each dealership should be \$3000 better off due to the change. Alternatively, if only 10% of the dealerships benefit, they would need to be \$30,000 better off. Assume that any change would be at least in that order of magnitude, then it is reasonable to conclude that the benefit to dealerships could exceed the regulatory burden.

Option 2E – Minimum five year terms with right of renewal

Under this option all dealer agreements would be required to have a minimum term of five years, with the dealer having the option to extend the term of the agreement by an additional five years, provided they meet the requirements outlined in the agreement.

The intent of this option would be to provide car dealers with sufficient time to recoup significant capital investments they are required to undertake.

Stakeholder feedback indicates that the majority of dealer agreements currently have five year terms with the franchisor having the option to renew the agreement.⁷⁴ This option would be broadly consistent with current industry practice, but would provide the dealer with the option to renew, rather than the manufacturer.

Impact on car dealers

This option could reduce the pressure felt by car dealers to undertake capital investment due to fear of non-renewal of their dealership agreement. Further, where capital investment is undertaken, this option could provide car dealers with more opportunities to recoup their investments. Providing greater certainty of tenure could also assist dealers to make informed decisions as to whether to undertake capital expenditure, as they could make an assessment regarding whether they may be able to recoup their investments during the term of the agreement.

Providing longer tenure and a right of renewal could also lessen the commercial pressure on new car dealers to put the interests of manufacturers ahead of consumers in order to maximise the likelihood that their dealer agreement will be renewed.

Although having minimum five year terms with an automatic right of renewal would increase certainty for dealers, it would also lock them into a particular way of doing business. This could result in dealers being required to continue to stock a brand that is not in demand due to changes in consumer preferences or technology and may reduce dealers' ability to innovate.

While having minimum tenure requirements may assist car dealers during the term of their agreement, in the transition to implement this option, some manufacturers may elect not to renew an agreement rather than be locked into a 10 year agreement. Manufacturers may also reconsider the entire dealer model (for example, by exploring direct manufacturer to consumer sales models), rather than be locked into a 10 year relationship.

For example, a manufacturer that was uncertain about the prospects of a particular dealership may have previously decided to enter into a three year agreement with the intention of reassessing the viability of the dealership at the end of the term. Instead such a manufacturer may decide to not renew an agreement, rather than be locked into what could potentially be a 10 year agreement.

⁷⁴ AADA 2017, p. 2 (Ibid footnote 65).

Impact on manufacturers

As outlined previously, the franchising model is predicated on franchisor control over the use of its brand, including the geographic footprint of the brand. Having minimum five year tenure with an automatic right of renewal would curtail a manufacturer's ability to manage its network to maximise overall profitability of the brand and dealer network.

According to the Federal Chamber of Automotive Industries (FCAI), the flexibility to manage the size of the overall network plays an important role in securing the health of the overall dealer network and the brands: 'The ability of the Distributor to manage the overall brand footprint in the market is a key to the health of all dealerships and the brand more broadly'.⁷⁵

For example, it is unlikely to be sustainable for a manufacturer whose market share halves over a 10 year period to maintain the same sized dealer network in year 1 and year 10 (assuming that initially the brand had an appropriately sized dealer network). In order to ensure the profitability of the brand and the entire dealer network, the manufacturer may seek to reduce the size of their dealer footprint.

The ability to have flexibility in managing networks and in managing relationships with dealers will become increasingly important in the coming years as the new car retailing sector adapts in response to technological improvements and changes in consumer preferences. Having what could effectively be 10 year terms could lock in particular ways of doing business at a time when innovation and change may be required to adjust to changing business conditions.

This option could also represent a barrier to entry for new car manufacturers looking to enter the Australian market. Industry consultation suggests that it is common for new entrants to initially have relatively short agreements (one to two years) as they test the Australian market. Minimum tenure could prohibit this practice and may restrict manufacturers' ability to enter into the Australian market, particularly as dealers may be unwilling to sign a five year agreement with an untested brand.

Net benefit

Although this option would reduce the commercial pressure on new car dealers, it could restrict manufacturers' ability to control the size and location of its dealer networks. It could also restrict both parties to enter into contracts with terms that meet their needs. In relation to the automatic right to renewal, this option could also force unwilling parties to enter into a commercial relationship, contrary to the existing principles of the Franchising Code and the CCA. This option could adversely impact consumers by reducing choice and the benefits of

⁷⁵ FCAI 2018, p. 3 (Ibid footnote 26).

price competition. Given that option 2D is expected to address much of the harm associated with car dealers being required to undertake significant capital expenditure without many of the downsides associated with having minimum tenure, option 2E does not have the highest net benefit and is therefore not a recommended option.

Regulatory burden

Total Option 2E Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	\$0.175			\$0.175

This option has a relatively low regulatory burden but potentially has significant economic ramifications. Specifically the lack of flexibility for manufacturers in changing market conditions could result in substantial costs, and a requirement for such long fixed terms could alter the decisions of manufacturers to enter into dealership agreements or, in the case of new entrants, the Australian market.

The regulatory burden incurred by manufacturers has been calculated to assume:

- it would take a lawyer one hour to draft the new term in their agreements at a cost of \$500 per hour; and
- an estimated 3500 agreements (the estimated existing number of franchisees) would be entered into following the end of the previous dealership agreement;
- the cost would be incurred over a 10 year period.

The cost as listed in the ‘non supported regulatory options’ table above is the expected cost in one year of the 10 year period.

Option 2F – Multi-franchisee dispute resolution

This option would explicitly allow franchisees to request multi-franchisee mediation to dispute similar issues with a franchisor.

It would not force a manufacturer to accept multi-franchisee mediation, but would simply allow it to be requested. This would avoid the risk of anti-competitive behaviour arising from collective bargaining through multi-franchisee mediation. As dealerships vary greatly in size from large publicly listed companies to small family run businesses there is a risk of larger companies accessing this avenue and tipping the balance of power too far in favour of new car dealers. Consequently limiting the ability of manufacturers to effectively manage its dealer network, which may negatively affect smaller dealers. This is consistent with the ACCC’s

proposed class exemption providing legal protection for all franchisees to collectively bargain with their franchisor regardless of their size or other characteristics.

Currently, the Franchising Code provides mechanisms for parties to a dealership agreement to try and resolve disputes in a timely and cost effective manner; however, it does not expressly state that parties may undertake multi-franchisee mediation when disputes of a similar nature arise within a franchise system nor does it prevent it.

The two dispute resolution mechanisms in the Franchising Code are that:⁷⁶

- franchisors must have an internal procedure for handling complaints that meets certain standards set out in the code; and
- either party can request mediation which, once requested, becomes mandatory for both parties to attend and genuinely attempt to resolve the dispute.

The mechanisms in the code are a way to bring the two parties together to resolve the dispute in an informal manner. They are not a way to reach a binding solution and they do not affect a party's right to take legal action over a franchising dispute.

The former Office of the Franchising Mediation Adviser (OFMA) reported that in the period from 1 January 2017 to 31 December 2017 there were a total of 288 requests for mediation filed with OFMA for which the Adviser appointed a mediator. Of these, mediation had begun in 266 matters and reports had been provided for 180 of these matters that had been completed during this period. In 149 of these matters, mediators reported that they conducted a mediation, of which 119 were resolved at mediation.

The office of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) currently administers the day-to-day functions of the Mediation Adviser, including fielding enquiries and advertising the availability of the service. Between starting to administer the adviser functions, between December 2018 and May 2019, ASBFEO has taken 187 enquiries relating to the Franchising Code of Conduct and acted on 100 cases relating to the Franchising Code of Conduct. Of these cases, 37 were referred to mediation, with five of the 37 cases not resulting in a negotiated outcome.

As stated previously, the Office of the Small Business Commissioner in NSW⁷⁷, has identified that dealers are reluctant to commence legal proceedings against a manufacturer due to concerns that doing so could cause irreparable damage to their commercial relationship, which

⁷⁶ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Part 4.

⁷⁷ Office of the NSW Small Business Commissioner 2017, [Submission on the draft report of the New Car Retailing Industry Market Study](#), OSBC, 6 September 2017, p. 2.

is the paramount concern for the dealer.⁷⁸ Furthermore, the OSBC received 20 dispute applications between July 2014 and December 2018 relating to dealer-manufacturer franchise agreements. A small number of additional dealerships approached the office to express concerns and raise complaints regarding their franchising agreement, without a view to initiating a dispute resolution.

Car dealers have also cited fear of retribution as a barrier to accessing assistance through a dispute resolution process. As a result, most dealers report concerns when the agreement has already been terminated or not renewed with the dealer applying for assistance with mediation as a result.

By explicitly allowing for multi-franchisee mediation, it could empower new car dealers, through strength in numbers, to formalise their complaint and seek a resolution (particularly if the problem is systemic).

The Victorian Automobile Chamber of Commerce (VACC) in its submission to the PJC Inquiry stated that there 'is a perception in the automotive industry that all regulators are powerless or lack the resources to assist franchisees in disputes against large multinational franchisors.'⁷⁹ Multi-franchisee mediation may increase the pool of resources available to franchisees and thereby increase their perception of the potential success of mediation.

National Dealer Councils (NDCs) exist as a mechanism for when concerns common to dealers within a franchise system can be raised with their manufacturer. Feedback to DISER suggests that the effectiveness of the NDCs as an informal forum to raise any concerns with the manufacturer tends to vary depending on the issue in question.

Impact on car dealers

This option is likely to benefit new car dealers because it may assist in equalising the imbalance of bargaining power between car manufacturers and new car dealers when resolving disputes and create a more efficient process and use of resources. The increased awareness of multi-franchisee dispute resolution could also assist groups of dealers that are being consolidated due to the franchisor changing their geographic footprint.

Industry stakeholders representing new car dealers have suggested that the dispute resolution procedures set out in the Franchising Code are not working as intended. Industry stakeholders have noted that taking legal action to resolve a dispute can be costly and time consuming and

⁷⁸ ACCC 2017, p. 87 (Ibid footnote 1).

⁷⁹ Victorian Automotive Chamber of Commerce 2018, Submission to Parliamentary Inquiry into the Operation and Effectiveness of the Franchising Code of Conduct, VACC, 4 May 2018, p. 10.

often puts the franchisee at a disadvantage, given the greater resources of the franchisor. Stakeholders note that the costs associated with taking legal action can mean that franchisees do not have access to justice, particularly when the franchisor is unwilling to reach a solution that works for both parties.

Through undertaking multi-franchisee mediation, new car dealers will be able to share resourcing and distribute the costs involved in undertaking the mediation. This may assist in making the dispute resolution process more cost effective and accessible, particularly to smaller dealers in regional areas.

Impact on manufacturers

By addressing issues in the one mediation process, it could potentially reduce legal costs and time spent mediating an outcome for car manufacturers. By not undertaking multi-franchisee mediation a car manufacturer would be required to separately resolve each issue with each new car dealer thereby increasing time and costs.

However by increasing the accessibility of dispute resolution, it could increase the number of car dealers becoming involved in mediation which could potentially increase costs (associated with implementing outcomes from the mediation) for car manufacturers.

Net benefit

This option could create benefits for both new car dealers and car manufacturers. It could empower car dealers and allow them to share costs and resources, whilst car manufacturers could also have cost and time savings. Any increase in cost to the car manufacturer would be outweighed by the cost and resource savings experienced by the car dealer that is now able to access mediation.

Regulatory burden

Total Option 2F Costs - Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	Nil			Nil

Since this option involves a regulatory amendment to clarify the existing ability for franchisees to undertake multi-franchisee mediation, it is anticipated that there is no regulatory burden resulting from this change.

As noted above, a benefit of this option is that it potentially equalises the imbalance between dealers and manufacturers. From a costing perspective, the negotiated benefit gained by dealers would equal the losses incurred by the manufacturers. However, both parties may have reduced legal costs due to efficiencies gained from conducting multi-franchisee mediation, which have been costed elsewhere at \$500/hr.

3 – Voluntary Code of Conduct

Under this option, the preferred proposals in option 2 would be implemented through a voluntary industry code of conduct, rather than by amending the existing Franchising Code.

As outlined in the Final Report of the Taskforce on Industry Self-Regulation:

“Self-regulatory schemes tend to promote good practice and target specific problems within industries, impose lower compliance costs on business, and offer quick, low cost dispute resolution procedures. Effective self-regulation can also avoid the often overly prescriptive nature of regulation and allow industry the flexibility to provide greater choice for consumers and to be more responsive to changing consumer expectations.”⁸⁰

However, the benefits of self-regulation can only be realised where it is effective at changing the behaviour of industry participants. The limited effectiveness of the voluntary Heads of Agreement on Access to Repair Information for Motor Vehicles, as identified by the ACCC in its market study, suggests that a voluntary code of conduct without a penalty regime is unlikely to change behaviour of participants in the new car retailing sector.

The mandatory Franchising Code already has provisions dealing with end of term arrangements, capital expenditure and dispute resolution – the three key problems identified in this RIS. Despite the Franchising Code being mandatory and seeking to resolve these problems, the issues continues to persist with particularly significant impact on car dealers. Given this, it is unlikely that a voluntary code of conduct would be effective.

In their submission to the RIS, the ACCC agreed with this assessment, noting that:

“The ACCC considers that mandatory solutions are required to overcome entrenched conduct in the new car retailing industry. A voluntary code is unlikely to resolve issues when there is a significant imbalance in power between parties. For example, as noted in our market study, we consider the earlier attempt to encourage car manufacturers to voluntarily share technical information has failed.

The ACCC agrees with the views expressed in the RIS that given voluntary approaches to franchising regulation failed, it appears unlikely that Option 3 would effectively address the identified problems.⁸¹

⁸⁰ The Treasury 2000, *Industry Self-Regulation in Consumer Markets – Report prepared by the Taskforce on Industry Self-Regulation – Final Report*, August 2000, p. 1.

⁸¹ ACCC submission to the RIS, p. 6.

Net benefit

While this options would have a lower regulatory impact than option 2, due to being self-regulatory, given past experience with voluntary approaches to franchising regulation failing, it appears unlikely that Option 3 would effectively address the identified problems.

Regulatory burden summary table

Supported Options

Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost (million)
Option 2: Franchising Code	Nil			Nil
Option 2A: 12 month notice period	\$2.46			\$2.46
Option 2B: Non-renewal notice	\$0.015			\$0.015
Option 2D – Significant capital expenditure disclosure	\$2.10			\$2.10
Option 2F – multi party dispute resolution	Nil			Nil
TOTAL				\$4.575

Non supported options

Average annual regulatory costs (ten years)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in cost (million)
Option 2C Stock buy-backs	\$31.6			\$31.6
Option 2E – Minimum terms	\$0.175			\$0.175
TOTAL				\$31.775

The regulatory burden estimates only consider the costs associated with complying with the reform option and do not include opportunity costs. For example, the regulatory costs for Option 2E account for the costs of updating dealer agreements, but do not include estimates of the costs for manufacturers associated with lost opportunities as a result of an inability to restructure dealer networks. These broader costs and benefits, which are excluded from the regulatory burden estimate, underpin the assessment as to which options are preferred and which are not.

There are also expected to be enforcement, education and compliance costs involved with the proposed changes. These costs are not considered as part of the regulatory burden costings but will be considered separately in consultation with the ACCC.

Preferred option

Option 2, regulatory intervention through amending the Franchising Code, is the preferred option as it is anticipated to have the highest overall net benefit. While maintaining the status quo or establishing a voluntary code of conduct would have a lower regulatory impact, neither option is likely to be effective at addressing the problems identified in the new car retailing sector. The preferred option would have a regulatory impact of ⁸²\$4.575 million per annum.

In regard to the elements of the regulatory intervention, options 2A, 2B, 2D and 2F are the preferred options. Including the existing elements of the Franchising Code will result in the components described below:

- It will work effectively for the sector, including the requirement to act in good faith and manufacturers' obligations in the case of transfer or termination of an agreement.
- Underpinned by the existing penalty and compliance regime for industry codes of conduct.

Regulatory changes

- Require manufacturers and dealers to provide 12 months' notice prior to non-renewing an agreement. (Option 2A)
 - When a non-renewal notice is issued, the manufacturers and dealer would be required to develop a plan and agree, with milestones, to end their agreement with an obligation on both parties to work co-operatively to settle arrangements.
 - The plan would need to address how stock levels (including spare parts, service equipment and new vehicles) will be managed.
 - Both parties may agree in writing to vary the notice period.

⁸² This total is derived from 3 components: 12 months' notice period; non-renewal notice and capital expenditure disclosure.

- The party not renewing the agreement would be required to provide a statement to the other party outlining why the agreement is not being renewed. (Option 2B)
- Capital expenditure disclosure obligations would seek to ensure dealers have sufficient information available to make an informed decision about the investment required and be clear on opportunity to recoup the investments. (Option 2D) This would include:
 - Manufacturers providing tailored disclosure in advance about the likely significant capital expenditure required during the term of the agreement.
 - Manufacturers would be obliged to disclose all available information necessary for the dealer to make an informed decision.
 - This disclosure could include indicative per square metre costs for materials and a general overview of the type of upgrades required.
 - The manufacturer and dealers discussing capital expenditure in detail, including how the costs of investment may be recouped during the agreement on offer.
 - Limiting the ability of manufacturers to direct dealers to undertake significant capital expenditure that was not disclosed.
- Explicitly allow for franchisees to request multi-franchisee mediation to dispute similar issues with a franchisor.

7. Implementation

If agreed to, the reforms would be implemented by amending the Franchising Code to incorporate additional obligations which only apply to dealership agreements. This is in line with the findings of the PJC report and will provide for timely implementation and alignment with the Franchising Code overtime.

DISER notes that the PJC Report made several recommendations for the broader franchising sector as well as specifically for the automotive sector. Some of these recommendations address concerns raised by new car dealers but may not address the full range of concerns. For example, to address concerns regarding end of term arrangements, the RIS and the PJC Report recommend extending the notice period for non-renewal to 12 months' however the RIS also recommends requiring reasons for non-renewal, in the case of a dealer receiving the notice, to allow a better assessment of their options. Therefore, DISER has sought to build upon the recommendations in the PJC Report to further address concerns' raised by dealers.

DISER recommends implementing these reforms through amending the Franchising Code to incorporate additional obligations which only apply to dealership agreements. This will allow for tailoring specific clauses for the automotive industry while allowing those that are compatible to standard franchise arrangements to remain consistent. This approach would have no practical difference to implementing the RIS options through a separate Automotive Code.

Further, implementing the RIS options as amendments to the Franchising Code would provide for future consistency with the Franchising Code. For example, following the outcome of the Wein Review,⁸³ the Franchising Code was amended to introduce civil pecuniary penalties for breaching certain provisions of the Franchising Code, such as the then newly introduced good faith provision.⁸⁴ However these reforms were not implemented in the Oil Code, creating inconsistency between the two Codes. This would also be a significant risk for new car dealers if the RIS options were implemented through a separate Automotive Code.

In addition, implementing the RIS options through amendments to the Franchising Code will be timelier than implementing the RIS options through a separate Automotive Code. Implementation through a separate Automotive Code will trigger a review of the broader provisions of the Franchising Code that would be brought over into the Automotive Code.

⁸³ Mr Alan Wein 2013, (Ibid footnote 14).

⁸⁴ [Explanatory Statement](#), Competition and Consumer (Industry Codes—Franchising) Regulation 2014.

Whereas, the implementation of the reforms proposed in this RIS through amending the Franchising Code will be implemented ahead of the Franchising Taskforce's work in considering the broader recommendations in the PJC Report (including for the new car retailing sector). Further, DISER is working closely with the Franchising Taskforce to ensure alignment of our work.

The changes would apply to new dealer agreements entered after a specified period of time after the Regulation is made. Existing agreements would continue to be subject to the Franchising Code until they are extended.

8. Consultation

DISER undertook public consultation on a draft RIS, the feedback of which has informed this updated RIS. DISER met one-on-one with 21 stakeholders and received 15 submissions. Meetings were held with a wide range of stakeholders, including industry associations, small rural dealerships, larger dealers and car manufacturers. An industry roundtable was also held on 8 February 2019.

Generally, stakeholders were in favour of the proposed amendments. However, stakeholder feedback indicated:

- it would be beneficial to manufacturers to also receive notice of non-renewal so as to facilitate management of its dealer network and ensure that consumers have access to service and repair facilities;
- some dealers are subject to targets set by the manufacturer, which involve levels of stock which must be held by a dealer and generally, but not always, manufacturers would work with dealers to manage down stock at the end of an agreement; and
- interest in linking the amount of capital expenditure required in a dealership agreement to the tenure allocated in the dealership agreement.

Based on feedback from consultation and the recommendation made by the PJC report, DISER recommends that the preferred outcomes be implemented by amending the Franchising Code as referred to in the Implementation section. More specifically, the options have changed to:

- extend the obligation to provide 12 months' notice when not renewing an agreement to dealers as well as manufacturers;

- 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);
- extend the obligation to provide a statement of reasons for non-renewal to dealers as well as manufacturers; and
- extend the obligation for pre-contractual disclosure of significant capital expenditure to include discussions about under what circumstances the dealer is likely to recoup the costs of their investment.

DISER also conducted further consultation with the AADA, MTAA and FCAI to obtain their feedback on the preferred implementation method and above identified changes to the options.

DISER received the following feedback:

- concern was raised that dealers can experience sudden economic challenges, such as low quarterly sales which can impact timing of providing notice. However, it was also acknowledged that negotiations on renewals of dealership agreements often begin more than a year in advance and it is in the best interest of the dealer to provide notice as early as possible in order to facilitate an orderly exit;
- extending the obligation to provide a statement of reasons for non-renewal to dealers was supported by all stakeholders; and
- concern was raised that discussion of how a dealer could recoup the costs of capital expenditure over the term of an agreement would not go far enough. However, this change was either supported or supported in principle.
- FCAI considered that the most appropriate implementation method would be through amending the Franchising Code, whilst the MTAA and the AADA preferred implementing the RIS options through a standalone Automotive Code.

Feedback provided by stakeholders which DISER has not recommended to implement has been included for discussion in our analysis of the options and the implementation method. Further consultation will be undertaken on exposure draft legislation, prior to a Regulation being made.

9. Evaluation

The amendments proposed in this RIS will be subject to any future reviews of the Franchising Code. Future review processes of the Franchising Code will be determined as part of the broader changes to the Franchising Code being undertaken by the Franchising Taskforce.

Appendix 1: Australian retail automotive industry

The Australian car industry consists of three main sectors:

- Manufacturers (represented by distributors) – import vehicles to distribute to dealers and commercial fleet buyers. Distributors are typically wholly owned subsidiaries of foreign car manufacturers and act as links between foreign manufacturers and Australian dealer networks.
- Dealers – sell new and used cars to consumers and businesses. While large businesses often purchase cars directly from distributors, smaller businesses typically purchase vehicles from dealers. Dealers also provide a range of other services, including servicing and repair, aftermarket sales and finance and insurance services.
- Independent repairers – typically small, independent establishments that service a local area.

Figure 1 shows the supply chain for new car retailing in Australia. Around 1.2 million new cars were sold during 2016–17, including at more than 1500 new car dealers operating more than 3500 retail outlets. The Australian market contains 72 brands and 400 models.⁸⁵ Car dealer revenues in 2016–17 are estimated at \$64 billion. Australia is one of the most open, competitive and deregulated car markets in the world.⁸⁶ Industry participants face barriers to entry by way of access to capital, infrastructure and having a dealership agreement in place in the case of dealers but they are not generally restricted on the sales channels they employ.

⁸⁵ AADA 2018, pp. 4-5 (Ibid footnote 37).

⁸⁶ IBISWorld Industry Report F3501 Motor Vehicle Wholesaling in Australia, May 2018, p. 30.

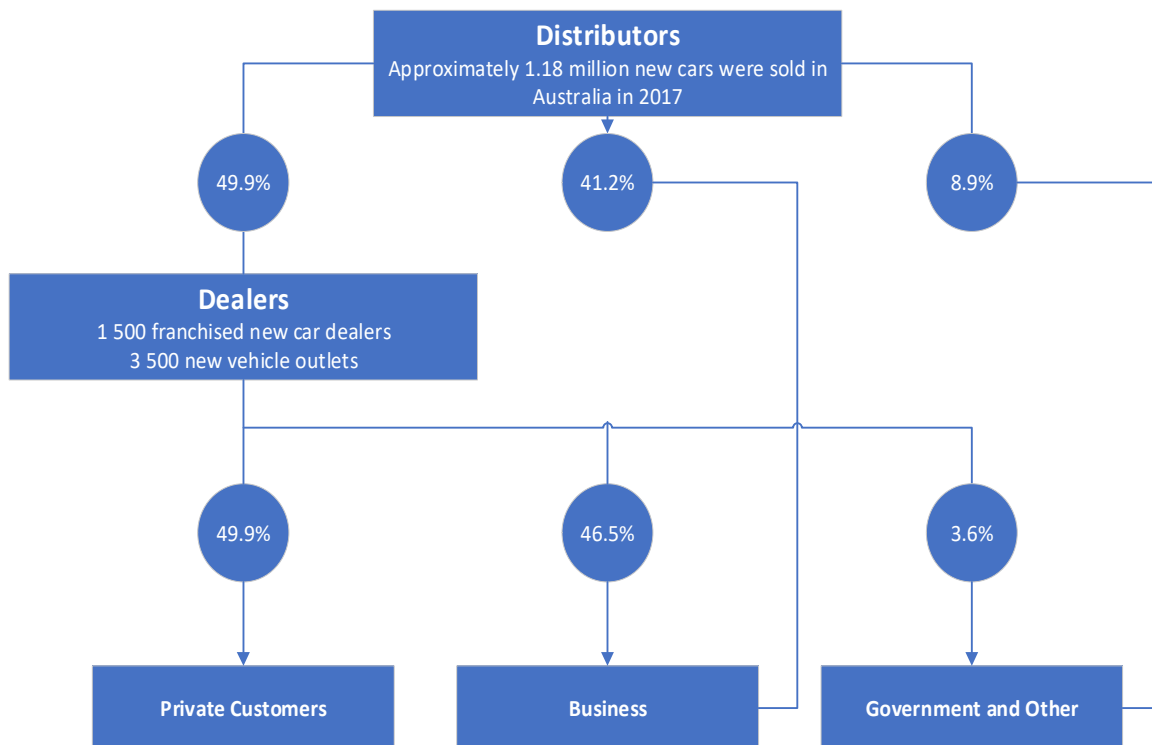


Figure 1: New Car Supply Chain.

Source: FCAI (VFACTS) motor vehicle sales data (as at December 2017); IBISWorld Industry Report F3501 Motor Vehicle Wholesaling in Australia, May 2018; *IBISWorld Industry Report G3911 Motor Vehicle Dealers in Australia*, April 2018.

Industry analysts predict automotive retail will shift from being product-driven to a customer-centric approach with key supply chain participants (manufacturers, dealers and independent repairers) garnering consumer loyalty through responding to consumer behaviour and expectations.⁸⁷ The move of Toyota New Zealand away from a traditional dealership to an agency model is illustrative of this shift (**Box 2** refers).⁸⁸

Substantial change is currently underway globally and locally, and further change driven by the following factors is predicted.⁸⁹

- Shifting consumer mobility preferences, such as increased demand for car-sharing services.
- Increased digitalisation, which is changing the way consumers purchase vehicles. Even where a vehicle is purchased at a dealership, much of the consumer's research is taking place online.
- Increased use of data analytics enabling car manufacturers and dealers to respond to changes in demand.

⁸⁷ [Innovating automotive retail, Journey towards a customer-centric, multi-format sales and service network](#), McKinsey, 2013; [Future of automotive retail](#), Ernst & Young, 2015.

⁸⁸ Maetzig, Rob 2018, [Toyota NZ ditches 'dealerships' for 'stores' in big changes to sales methods](#), Stuff, 29 March 2018.

⁸⁹ AADA 2017 p. 4 (Ibid footnote 15).

- Altered supply chains resulting from the cessation of motor vehicle manufacturing in Australia in 2017 and new free trade agreements.
- An increased consumer preference for automated, electric/hybrid vehicles and downsizing of internal combustion engines (ICEs) and increased use of complex computer systems which will change consumer servicing needs. Specialised equipment and new skills are required to service cars with complex computer systems and electric cars have fewer fluids and moving parts and require less servicing.

The MTAA, the national peak body for Australian automotive retail, service, repair and recycling industry states:⁹⁰

‘The retail, service, repair and recycling sectors of the Australian automotive industry are expected to face significant adjustment, or complete restructure, in the short to medium-term. This will profoundly reshape business models, products and service provision and consumer/stakeholder relationships. As a result of this adjustment, some businesses will be forced to exit the industry, while others will need to adapt to seize opportunities for growth and long-term sustainability.’

Box 2: Toyota New Zealand (NZ) agency model

In March 2018 Toyota NZ announced moves away from a dealership model to an agency model where dealers are to become Toyota agents - called Stores - and they will be paid a fee to deal with customers. Vehicles will not carry recommended retail prices, which means there will no longer be any negotiation between dealers and consumers over price. Staff will be salaried product specialists and not commission-focussed sales people.

Toyota NZ intends to also continue to sell cars from dealerships and actually double the number of vehicles on yards but the stock at the stores will be demonstrators, and all cars purchased will then be delivered from one of its three hubs. Toyota states that the move was customer driven – customers can be assured about price transparency, do not have to feel like they have to bargain to get the best deal, recognises that most customers do on-line research before buying cars and expect the widest availability of choice and customisation.

Recent media coverage, submissions to the PJC Inquiry, and anecdotal evidence presented to DISER in its one on one consultations has suggested that in response to increased competition distributors have made the decision to reduce their footprint in some areas of Australia. This has necessarily resulted in non-renewal of dealership agreements.⁹¹

⁹⁰ MTAA 2018, [An industry at crossroads: Automotive 2018](#), MTAA, p. 2.

⁹¹ Turnbull, Samantha; MacKenzie, Bruce; Shoebridge, Joanne 2017, (Ibid footnote 42); MTAA 2018 p. 5 (Ibid footnote 66).

Appendix 2: Franchising Code obligations

Rights and obligations of parties under the Franchising Code

Pre-contractual rights

Disclosure

Franchisors are required to disclose certain information and provide specific documents to prospective franchisees. These documents include⁹²:

- an information statement on the risks and rewards of franchising;
- a copy of the Franchising Code;
- a disclosure document; and
- a copy of the franchise agreement in its final form.

Cooling off

A prospective franchisee is entitled to a seven day cooling off period after entering into a new agreement or making any payment under the agreement, whichever occurs earlier. The cooling off period does not apply to transfers, renewals or extensions of an existing agreement.⁹³

General obligation to act in good faith⁹⁴

The Franchising Code contains an obligation for all parties to a franchise agreement to act in good faith towards one another in respect of any matter relating to their agreement or the Franchising Code.

The obligation to act in good faith also applies to parties who propose to enter into a franchise agreement.

⁹² *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clauses 9, 11.

⁹³ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 26.

⁹⁴ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 6.

Rights and obligations during the agreement

Marketing fund⁹⁵

If the franchisor operates a marketing fund, the franchisor must maintain a separate bank account for the fund and contribute to the fund on the same basis as other franchisees for each company owned store that a franchisor operates. Marketing and advertising fees may only be used to meet certain expenses.

If a marketing fund is used, the franchisor must prepare an annual financial statement for the fund. The annual financial statement must set out meaningful information about sources of income and items of expenditure.

The annual financial statement must also be audited by a registered company auditor, unless 75 per cent of the franchisees that contribute to the fund vote not to do so.

General release

A franchise agreement must not require a franchisee to sign a general release of the franchisor from liability towards the franchisee.⁹⁶

Transfer⁹⁷

A franchisee that wants to transfer an agreement must seek the franchisor's consent in writing. A franchisor must not unreasonably withhold their consent. The Franchising Code contains a non-exhaustive list of circumstances in which it would be reasonable for a franchisor to withhold consent.

Consent is assumed to be given by the franchisor after 42 days unless the franchisor advises the franchisee in writing that they do not consent.

Restraint of trade⁹⁸

A restraint of trade clause in a franchise agreement will have no effect when a franchisee has sought to extend their agreement and the franchisor does not agree and the franchisee:

- had sought to extend the agreement on substantially the same terms as those contained in the franchisor's current agreement that applies to other franchisees or would apply to a prospective franchisee; and
- was not in breach of their agreement or any related agreement; and

⁹⁵ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clauses 15 and 31.

⁹⁶ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 20.

⁹⁷ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 24.

⁹⁸ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 23.

- had not infringed the intellectual property of the franchisor or breached any confidentiality agreements; and
- received only nominal, and not genuine, compensation for goodwill; or
- the agreement provided no avenue by which to claim compensation in the event it was not extended.

*Dispute resolution*⁹⁹

The Franchising Code provides mechanisms for parties to a franchise agreement to try and resolve disputes in a timely and cost effective manner. The two dispute resolution mechanisms in the code are that:

- franchisors must have an internal procedure for handling complaints that meets certain standards set out in the code; and
- either party can request mediation which, once requested, becomes mandatory for both parties to attend and genuinely attempt to resolve the dispute.

The mechanisms in the code are a way to bring the two parties together to resolve the dispute in an informal manner, they are not a way to reach a binding solution and they do not affect a party's right to take legal action over a franchising dispute.

Parties must pay their own mediation costs and parties split the costs of the mediator equally.

*Significant capital expenditure*¹⁰⁰

A franchisor must not require a franchisee to undertake significant capital expenditure, which is not defined in the Franchising Code. However a franchisor can require franchisees to incur significant capital expenditure where the expenditure:

- was disclosed to the franchise in the disclosure document; or
- will be incurred by a majority of franchisees and a majority of franchisees approve the expense; or
- is necessary to comply with legislative obligations; or
- has been agreed to by the franchisee; or
- is considered necessary by the franchisee as a capital investment in the business, justified by a statement which sets out the:
 - rationale for making the investment;
 - amount of capital expenditure required
 - anticipated outcomes and benefits; and

⁹⁹ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see Part 4.

¹⁰⁰ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 30.

- expected risks associated with the investment.

*Non-renewal*¹⁰¹

The Franchising Code does not require franchisors to renew a franchise agreement once it expires. However, if the term of the agreement is six months or longer, the franchisor must notify the franchisee at least six months before the end of the term of the agreement whether they intend to:

- renew or not renew the franchise agreement; or
- enter into a new agreement.

¹⁰¹ *Competition and Consumer (Industry Codes—Franchising) Regulation 2014*, Schedule 1, see clause 18.