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The Treasury

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Automotive franchising

Discussion paper
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Consultation Process

Request for feedback and comments

Interested parties are invited to comment on the issues raised in this discussion paper.

While submissions may be lodged electronically or by post, electronic lodgement is preferred.

All information (including name and address details) contained in formal submissions will be made available to the public on the Australian Treasury website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment.

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View Treasury's [Submission Guidelines](#) for further information.

Closing date for submissions: 13 September 2021

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The options outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the options might operate.

Overview

On 1 June 2021, the Government [released a range of amendments](#) to the Franchising Code of Conduct (Franchising Code). These include amendments to the automotive part of the Franchising Code and deliver on commitments made on 12 March 2021 by the Prime Minister, the Hon Scott Morrison MP and the former Minister for Employment, Skills, Small and Family Business, Senator the Hon Michaelia Cash, to:

- transform existing voluntary principles for new vehicle dealerships into mandatory obligations under the Franchising Code; and
- explicitly recognise that new vehicle dealers operating as a manufacturer's agent in relation to new vehicle sales are still protected by the Franchising Code.

The reforms build on the work done by the Australian Government following the introduction of an [automotive part](#) to the Franchising Code on 1 June 2020 (the first time a sector specific part of regulations had been included in the Franchising Code), the Government's response to the Parliamentary Joint Committee's (PJC) 2019 *Fairness in Franchising* report on 20 August 2020, and the announcement of the voluntary best practice automotive principles on 11 December 2020.

Further to the 12 March 2021 announcement, the Government also committed to significantly increase penalties for wilful, egregious and systemic breaches of the Franchising Code and consult on potential further automotive franchising reforms to:

- ensure appropriate protections for automotive dealerships from unfair contract terms in their agreements with manufacturers;
- consider the merits of a standalone automotive franchising code; and
- consider options to achieve mandatory binding arbitration for automotive franchisees.

This paper seeks stakeholder views to help Government assess the practical benefits of a standalone automotive franchising code and options for mandatory binding arbitration, and how best they could be implemented. The paper also seeks views on broader scope considerations for the Franchising Code related to the contribution of other vehicle types to the sector.

The Government has already committed to reforms to enhance the existing protections against unfair contract terms in the Australian Consumer Law (ACL), which were agreed by State and Territory consumer ministers in November 2020. These reforms will benefit small businesses and consumers. For small businesses, the reforms include increasing eligibility of the protections to capture a greater number of small businesses. The Government will soon release the exposure draft legislation on the reforms to the unfair contract term protections for consultation. The Government is also working with the automotive sector to ensure new vehicle dealerships are adequately protected from unfair contract terms.

Consideration of additional automotive franchising reforms

Standalone automotive franchising code

The Government has recently introduced a separate part under the Franchising Code of Conduct (the Franchising Code) that deals specifically with automotive franchising issues.

The Government is now seeking further information and evidence from stakeholders to determine whether there is merit in further regulatory reform for the automotive industry which could take the form of a standalone automotive franchising industry code – a separate code that would no longer be part of the Franchising Code.

Table 1: Explainer – industry codes of conduct

What is an industry code of conduct?	What are the limitations of industry codes?
<p>A set of standards of conduct for industry participants to better ensure risk is allocated efficiently between parties to enhance the operation of the market.</p> <p>Prescribed under the <i>Competition and Consumer Act 2010</i> (CCA).</p> <p>Works in tandem with economy-wide fair trading requirements under the Australian Consumer Law (ACL), including in relation to misleading, deceptive and unconscionable conduct, and unfair contract terms.</p> <p>Tends to contain requirements to improve transparency and certainty in contracts, set minimum standards of conduct, and provide for dispute resolution procedures.</p>	<p>Industry codes are prescribed by regulations under the CCA – which places limits upon the types of things that can be regulated.</p> <p>Not designed to regulate every aspect of the dealings between industry participants or to provide absolute protection to smaller participants from competitive pressures that relate to bargaining power, access to markets or limited scale when purchasing.</p> <p>Not used to restrict competition or unduly interfere with the parties’ freedom to contract.</p>

When does the Government intervene with an industry code of conduct?

As a general principle, the Government considers that markets should be free to operate without excessive regulation. It will only prescribe a mandatory industry code in very limited circumstances – when there is robust evidence showing it is necessary to support the efficient operation of a market.

The criteria for prescribing industry codes are set out in the [Industry Codes of Conduct Policy Framework](#) (2017):

1. A clearly identified market failure.
2. A problem that can’t be addressed using existing regulation.
3. Self-regulation has been attempted and failed.
4. Evidence that a code is the most effective solution.
5. Public benefits that outweigh the costs of regulation.

MARKET FAILURE

Problems with the operation of a market that prevents it producing optimal outcomes.

Example 1: Asymmetric information - market participants do not have access to the same information.

Example 2: Imperfect competition - exercise of market power by firms can lead to inefficient outcomes.

Recent consideration of a standalone automotive franchising code

Following the 2017 market study of new car retailing by the Australian Competition and Consumer Commission (ACCC), a 2018 [Regulation Impact Statement](#) explored the option of a standalone code. It considered that automotive-specific amendments to the Franchising Code would allow for future consistency with the Franchising Code.

The 2019 Parliamentary Joint Committee [Fairness in Franchising](#) report also extensively considered the issue of a separate automotive code. It considered the issues raised by dealers were not unique and overlapped with many of the issues identified by other sectors within franchising. Mindful of disadvantages that arise with the fragmentation of codes into multiple codes, it considered that automotive franchisees' concerns should be addressed through the existing Franchising Code. The Government introduced specific provisions for new vehicle dealerships as part of the Franchising Code on 1 June 2020.

The March 2021 Senate inquiry report, [Driving a fairer deal: regulation of the relationship between car manufacturers and car dealers in Australia](#), urged the Government to comprehensively assess whether a standalone automotive code of conduct would be a more appropriate approach for regulating the relationship between car manufacturer and dealers. On 12 March 2021, the Government committed to consult on the merits of a standalone automotive franchising code.

What is the problem to be addressed?

The Senate inquiry found that multi-national corporations that are car manufacturers can exploit new car dealers due to a power imbalance. Concerns were raised about the failure of manufacturers to work with dealers to:

- ensure opportunity for recoupment of capital investments;
- ensure unfair contract terms are eliminated from franchise agreements;
- adequately reimburse dealers for warranty and recall work; and
- provide fair and reasonable compensation when dealership agreements are terminated or not renewed.

Automotive dealers maintain they are different to other franchise businesses due to:

- association with off-shore multinational corporations;
- significant up-front capital investment required for establishing a franchise business;
- dealers tending not to pay franchise fees or other financial payments to franchisors; and
- longer-term after-sale interactions with customers.

What is the Government doing already?

Automotive franchising is regulated by the mandatory Franchising Code. The Code includes general protections for all franchise agreements, including automotive franchises. Automotive franchising is also subject to the law of contract and the ACL. The ACL addresses misleading or deceptive conduct, false or misleading representations, unconscionable conduct and unfair contract terms for small business contracts. It also contains a range of consumer guarantees and a requirement for manufacturers to indemnify suppliers with respect to those guarantees.

As an independent statutory body the ACCC is the regulator for the Franchising Code and sets its own compliance and enforcement priorities annually while the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) provides access and support for resolving disputes between franchisees and franchisors.

On 1 June 2020, a new part of the Franchising Code was introduced specifically for new vehicle dealerships to require dealership agreements to take into account additional considerations regarding end of term arrangements, capital expenditure and multi-party dispute resolution. This was the first time that industry specific regulations had been included in the Franchising Code.

On 1 July 2021, further protections for new vehicle dealerships came into force. Franchising agreements between automotive manufacturers and dealers must specify how compensation for automotive franchise dealers is to be determined if the manufacturer withdraws from the market, or changes its network or distribution model. The amendments also include a clarification that the Franchising Code's protections apply to dealerships operating under agency models.

The ACCC also authorised a class exemption from 3 June 2021 that improves and simplifies access to collective bargaining for franchisees when negotiating with franchisors. This exemption applies to all franchisees, including automotive dealerships which have already started utilising the class exemption process.

The ACL already contains protections for small businesses from unfair contract terms, and the Government is strengthening these protections and expanding the number of small businesses covered by them.

The ACL also creates a right for suppliers to seek indemnification from manufacturers where the supplier provides a remedy under the consumer guarantees due to a manufacturing defect. Commonwealth, State and Territory consumer ministers have agreed to test options to strengthen these arrangements through a regulatory impact assessment process.

The Government has amended the CCA to include a new part for a mandatory scheme for the sharing of motor vehicle service and repair information. This new scheme, to commence on 1 July 2022, will require data providers (often car manufacturers) to share all service and repair information with Australian repairers, including dealerships, at a fair market price.

The Government is seeking information on any remaining issues or problems that may not be adequately addressed by the recent reforms that could be addressed in the Franchising Code or a standalone Code. It is also seeking information on which of these approaches would be more appropriate. Stakeholders are requested to provide evidence as there will need to be a clear evidence base that a problem exists in these areas before the Government considers taking additional actions.

Options for further supporting the automotive industry

Option 1: Amend the Franchising Code and its automotive specific provisions when required

This is the status quo option in terms of maintaining the current approach to regulation. As the franchising sector and automotive industry evolves, the Franchising Code and its specific automotive provisions can be amended to address emerging issues. This allows the automotive industry to benefit from consistency in the laws and protections afforded to the franchising sector as a whole, while providing scope for specific matters to be addressed that may be unique to the industry. However, there may still be perceptions that automotive specific industry needs are not being adequately addressed. Others may be of the view that more time is needed to allow these recent changes to fully take effect.

Option 2: Establish a standalone automotive franchising code

A new, standalone code for automotive franchising could provide more tailored regulation that meets the unique needs of the automotive franchising sector and better communicates expected

behaviours. Parties to automotive franchising could be subject to this new code rather than the Franchising Code. Like Option 1, this could also provide the opportunity to tailor and broaden the scope of protections and reflects concerns by manufacturers and dealers on the nature of their relationship being different to other franchise businesses.

If a new standalone automotive franchising code were to be prescribed under the CCA, the code would have the same legal standing and be enforced in the same way as the Franchising Code. A new code prescribed under the CCA would also be subject to code limitations (outlined in Table 1).

Codes evolve separately over time to meet different and emerging needs. Over time, a standalone automotive franchising code could become inconsistent with the broader Franchising Code, as has occurred with the Franchising Code and Oil Code. This means some businesses may miss out on protections that other businesses have gained over time. Stakeholders may find these differences confusing and unfair.

Are provisions needed to cover other vehicle types?

The Franchising Code regulates all franchise agreements entered into in Australia, and expressly includes all motor vehicle dealership agreements.

The automotive-specific part introduced to the Franchising Code on 1 June 2020 (and further automotive reforms on 1 July 2021) only apply to new motor vehicle dealership agreements of new passenger road vehicles or new light goods road vehicles. These stem from the ACCC's 2017 [market study into the new car retailing industry](#) which first explored the issue, and the Government's regulatory analysis of the franchise relationship between car manufacturers and new car dealers. The amendments were only intended to cover new road motor vehicles and excludes all other motor vehicles such as motorbikes, farm machinery and trucks given there was limited evidence submitted at the time to support expanding the scope beyond new cars.

Stakeholders are invited to provide evidence to support the consideration of expanding protections for new vehicle dealerships to other parts of the automotive sector.

These protections could be considered under any of the above options.

Questions

1. What are the key problems or issues being faced by the automotive sector that you believe have not adequately been addressed by the Government's recent reforms?
2. What evidence can you provide about the magnitude of the problem (i.e. quantitative and qualitative data)?
3. Which option do you consider to be the most effective solution and why?

Options for arbitration

The Government's 12 March 2021 announcement committed to consider options for arbitration for automotive franchisees to address power imbalance when there is a dispute. This section discusses the Government's recent franchising dispute resolution reforms and considers how arbitration options/models could be implemented to help strengthen arbitration for automotive franchising disputes under the Franchising Code.

What is the problem to be addressed?

The Government has recently heard from stakeholders, primarily new car dealers, that they need better mechanisms to resolve disputes with manufacturers. Stakeholders have argued that manufacturers exploit a power imbalance through a lack of genuine negotiation. The PJC's *Fairness in Franchising* report pointed to circumstances when franchisors would leverage the power imbalance as part of the mediation process to achieve settlement, knowing the franchisee could not afford a long court process. This issue was also raised in the Senate Inquiry report, and recommended the Government introduce mandatory binding arbitration to resolve disputes during contract negotiation in the automotive industry which are not able to be resolved by other dispute resolution mechanisms.

What is the Government doing already?

The Franchising Code sets out the process for managing franchising disputes, which can be initiated by either party. Some jurisdictions also provide auto-specific dispute resolution mechanisms¹ separate to the Franchising Code, considered by relevant state and territory small business commissioners. In the majority of cases, franchising parties have successfully utilised mediation under the Franchising Code with a high degree of disputes resolved in good faith, facilitated through ASBFEO² and state and territory small business commissioners.

The Government has also recently introduced legislative amendments that:

- introduce voluntary binding arbitration and conciliation to the Franchising Code's dispute resolution toolbox;
- give ASBFEO the role to appoint a mediator or arbitrator to support the resolution of a franchising dispute between industry participants when requested;
- clarify multi-party dispute resolution applies to new vehicle dealership agreements;
- transform the existing automotive franchising principles into mandatory obligations; and
- increase penalties for breaches of the Franchising Code.

The Franchising Code's voluntary binding arbitration mechanism is based on the processes outlined in the Dairy Code of Conduct³. If negotiations between the parties fail, arbitration is triggered by the parties agreeing (in writing) to resolve their dispute by arbitration, in whole or in part.

¹ South Australia Fair Trading (Motor Vehicle Industry Dispute Resolution Code) Regulations 2014 known as the Motor Vehicle Industry Dispute Resolution Code; New South Wales Motor Dealers and Repairers Act 2013 which refers dealer disputes on unjust conduct or unfair contract terms to the NSW Small Business Commissioner.

² During January to March 2021, ASBFEO reported that 100 per cent of parties taking part in Franchising Code mediation via ASBFEO did so in good faith, with an 89 per cent resolution rate. This is compared to the average 58 per cent resolution rate in previous quarters, and where an average 96 per cent of parties acted in good faith.

³ See <https://www.legislation.gov.au/Details/F2019L01610>, Part 2.

Notable features of voluntary arbitration in the Franchising Code include:

- arbitration can apply to disputes under existing franchising contracts;
- parties may request the appointment of a particular arbitrator;
- there are no time-limits to resolve the dispute, but good faith obligations apply; and
- the arbitration process is confidential.

What is mandatory binding arbitration?

Mandatory binding arbitration allows one of the parties to bring a dispute to an independent third party (arbitrator) for a determination, and both parties are bound by the arbitrator’s decision. The benefits of arbitration include it being confidential; a more efficient and economical exercise than litigation; and parties can secure a determination in circumstances where mediation has failed. Arbitration also carries costs and risks for industry participants, including those that arise from being required to accept contractual terms set by a third party, and the risk of discouraging compromise in negotiations prior to arbitration. However, it may encourage parties to reach agreement prior to pursuing formal dispute resolution processes.

What are the limitations in having mandatory binding arbitration in the Franchising Code?

The scope of arbitration under a mandatory industry code is limited by the Constitution. Under the Constitution only the courts can exercise judicial power (it cannot be conferred on persons or bodies). The Senate Inquiry report noted that the introduction of provisions imposing compulsory/mandatory arbitration in codes of conduct can be problematic⁴ and can only be triggered in a limited number of ways to overcome these limitations. An analysis of each option is below:

Options	Purpose	Observations
A. Mandatory arbitration in a voluntary Code	Parties agree to be bound by the Franchising Code’s provisions, including mandatory binding arbitration (e.g. by the decisions of Code Arbiters appointed under the Food and Grocery Code)	Unless all new vehicle manufacturers agree to sign up to a new voluntary automotive code – it is unlikely that this approach would be feasible. Dealers that do business with manufacturers that are not signatories to such a code would not have access to the code protections or dispute resolution mechanisms.
B. Voluntary arbitration in a mandatory Code	Parties are not bound to undertake arbitration but can agree to do so (e.g. Dairy Code of Conduct)	This has already been implemented through the amendments to the Franchising Code. Parties are also able to resolve disputes through voluntary arbitration if it is provided for in their respective franchising agreements.
C. Mandatory arbitration in a mandatory code in relation to future obligations only	Arbitrator takes a forward looking approach in deciding what is commercially fair in resolving negotiating deadlocks between parties that are unable to agree on particular contractual terms (e.g. Sugar Code).	The Sugar Code and Media Bargaining Code currently apply this option as the determination of future rights does not involve an exercise of judicial power. This is also often applied in a pre-contractual context, discussed further below.

⁴ Senate Education and Employment References Committee, *Driving a fairer deal: Regulation of the relationship between car manufacturers and car dealers in Australia* (2021), 62-63.

What more can be achieved in a mandatory industry code?

It is important to note that the implementation of recent reforms to the Franchising Code are significant and the effect of the changes, particularly the introduction of new voluntary arbitration processes, will take time to flow through and have an impact on the ground as new franchising agreements are entered into.

It is clear that the application of mandatory arbitration in the context of a mandatory code is limited and can only apply in relation to future obligations. The application of a pre-contractual mandatory arbitration process is therefore the only scope for additional reform for the automotive franchising industry in situations where the parties are unable to resolve disputes through other dispute resolution mechanisms. But further consideration is needed to understand the practical challenges to implement such arrangements.

What is pre-contractual arbitration?

Pre-contractual arbitration involves having an arbitrator determine a dispute while parties are negotiating/bargaining a contract. The arbitration is therefore concerned with determining what will be, rather than what are, the rights and obligations between parties and how that would be incorporated into an eventual agreement. There are two models that could be considered in this context and within the constitutional limitations (also see Table 2 comparison below).

Pre-contractual arbitration in an automotive franchising context requires careful consideration given its differences to other industries. Automotive franchising relationships and agreements between manufacturer franchisors and dealer franchisees are usually longer term and require a high degree of commitment and communication particularly on issues about compensation in the event of early termination of an agreement for example. It should also be noted that pre-contractual arbitration is usually used in industries where there is a limited and manageable number of agreements and/or a limited range of issues subject to pre-contractual arbitration (e.g. remuneration). The automotive franchising industry is characterised by a high number of agreements between manufacturers and dealers that may cover a vast range of commercial matters.

Option 1: Pre-contractual arbitration model

Pre-contractual arbitration is currently used in industry codes of conduct like the Sugar Code⁵ and Wheat Code⁶ which deal with transactional agreements like the supply of sugar, or access to port terminal services. As the parties are mutually dependent, the arbitration mechanism helps break negotiation deadlocks in a timely manner to avoid further delays to business operations. Under this model, if negotiations between the parties fail, arbitration can be triggered by one party notifying the other that arbitration should start.

Other features include:

- arbitration applies to pre-contractual disputes (not disputes under existing contracts);
- arbitration can be about any term in the proposed agreement;
- parties can submit written representation to the arbitrator to consider in making its decision;
- the arbitration must be determined within 35 days; and
- the arbitration process is confidential.

⁵ <https://www.legislation.gov.au/Details/F2017L00387>, Schedule 1, Part 4.

⁶ <https://www.legislation.gov.au/Details/F2014L01250>, Schedule 1, Part 3.

Option 2: Arbitration model used in the Media Bargaining Code

Stakeholders and the Senate Inquiry report have suggested applying the arbitration mechanism in the News Media and Digital Platforms Mandatory Bargaining Code to the Franchising Code. The Media Bargaining Code deals with the transactional arrangement between news media businesses and digital platform providers like Google/Facebook on the payment of news content. The Media Bargaining Code was introduced to promote the sustainability of public interest journalism by addressing power imbalances which resulted in news media businesses accepting less favourable terms for the inclusion of news on Google/Facebook services than they would otherwise agree to.

The Media Bargaining Code is based in primary legislation which differs to the franchising context. The Media Bargaining Code applies mandatory pre-contractual binding arbitration processes, and includes provisions and protections unique to the media industry. These new measures are yet to be tested. Under this model, arbitration can be accessed if parties meet certain conditions, and commences after one party notifies the ACCC (in writing) that arbitration should start.

Other features of this model include:

- applying only to pre-contractual disputes (not existing disputes under existing contracts);
- is limited to disputes about remuneration;
- is based on a ‘final offer’ arbitration process rather than conventional commercial arbitration and is time-limited to encourage parties to resolve their dispute quickly; and
- under exceptional circumstances, an arbitrator can refuse parties’ final offers based on public interest grounds (if it is a serious detriment to consumers), or can adjust the final offer.

Other factors for consideration of pre-contractual arbitration

In applying either option, there are a range of factors to consider in the design of a pre-contractual arbitration model, including:

- at what point a party becomes bound to engage in pre-contractual arbitration;
- what types of disputed terms could be best suited for pre-contractual arbitration;
- what applicable factors would arbitrators base their decision on when making a determination i.e. commercial fairness/reasonableness, direct/indirect benefits;
- whether arbitrators are able/willing to arbitrate such matters;
- whether pre-contractual arbitration would adversely affect the relationship of parties who are at the start of their franchising relationship; and
- how pre-contractual arbitration would interact with the existing dispute resolution mechanisms and other protections in the Franchising Code.

The introduction of pre-contractual arbitration (either through the existing Code or via a new standalone Code) will require further consultation with industry, particularly on the type of matters that could be determined by pre-contractual arbitration and what risks (if any) would arise.

Table 2 – comparison of arbitration model features

Features	Media Bargaining Code	Sugar Code	Franchising Code
Mandatory or voluntary	Mandatory	Mandatory	Voluntary
Pre-contractual or existing disputes	Pre-contractual	Pre-contractual	Existing
General or specific dispute types	Limited	General	General
Information requests or written representations allowed	Yes	Yes	Not specified
Arbitration time limits	35 day limit	35 day limit	Not specified

Option 3: Industry-led improvements to dispute resolution

As an alternative or complementary measure to either the existing Code or further reforms, industry-led improvements to dispute resolution in automotive franchising dealership agreements could assist in achieving further benefits for the sector.

Some stakeholders have pointed to the arbitration processes in the Canadian *National Automobile Dealer Arbitration Program (NADAP)*⁷ for further exploration. The NADAP was established in 1997 by Canadian automotive manufacturers and dealers to provide an expeditious, impartial and less expensive means for resolving the disputes that arise from time to time between them. It features specific rules and procedures for a range of disputes to be submitted to private arbitration. These decisions are private but available for other NADAP members to review. NADAP has limited application which industry will need to further consider:

- NADAP has had success in resolving common contractual disputes, but it is not intended to resolve multi-party disputes or complex disputes; and
- there may be certain types of dispute that can only, or should only, be determined or enforced through the courts.

Further, to support the Mandatory Motor Vehicle Service and Repair Information Sharing Scheme⁸ (Scheme), automotive peak industry groups are working to establish an industry-led organisation to support the Scheme's operation. The organisation's functions will include, amongst other things, assisting in resolving disputes between data providers (often car manufacturers) and Australian repairers seeking access to service and repair information. The industry organisation will not be responsible for undertaking mediation or other forms of dispute resolution but will refer parties to appropriate resources. The Scheme sets out that the parties must attend mediation however, outcomes are not binding. These new measures are still being developed.

Questions

1. Could pre-contractual mandatory arbitration enable better access to justice for dealers in relation to resolving disputes?
2. What types of contract terms could be best suited to a pre-contractual arbitration model?
3. What measures could be put in place to reduce any potential risks of adversely affecting the franchising relationship before the contract starts?

Next steps

Feedback to this discussion paper will inform advice to Government. Please submit your feedback, including relevant examples, in response to the questions presented above or other appropriate matters that would aid the Government's consideration of these issues.

A post-implementation review of the most recent amendments to the automotive part of the Franchising Code must be completed by mid-2023 and a review of the Franchising Code must be undertaken prior to the code sun-setting on 1 April 2025. These will also provide further opportunity for consideration of the effectiveness of these reforms and whether further reform is necessary.

⁷ National Automobile Dealer Arbitration Program (NADAP), <<https://adrchambers.com/programs/nadap/>>, accessed 22 April 2021.

⁸ Motor Vehicle Service and Repair Information Sharing Scheme – Industry Partnership – Info sheet (April 2021) <https://treasury.gov.au/sites/default/files/2021-05/c2020-128289_industry_partnership.pdf> accessed 24 May 2021.