AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

RESPONSE TO THE AUTOMOTIVE FRANCHISING DISCUSSION PAPER 2021

13 SEPTEMBER 2021

CONTENT

FOREWORD

The Australian Automotive Dealer Association (AADA) is the peak industry advocacy body exclusively representing franchised new car Dealers in Australia. We appreciate the opportunity to provide this submission to Treasury's discussion paper on automotive franchising.

There are around 1,500 new car Dealers in Australia that operate more than 3,000 Dealerships. The new vehicle retailing sector employs more than 55,000 people including almost 4,500 apprentices. It contributes over 14 million in community donations nationally, has a total turnover/sales of more than $55 billion and generates more than $2 billion in tax revenue.

The AADA welcomed the amendments made to the automotive-specific provisions of the Franchising Code which took effect on 1 July. We also welcome the further consultation currently being undertaken. The need for these regulations has come about because of the actions undertaken by several manufacturers. Actions which left customers stranded and adversely affected Australian Dealers and their employees. It saw both sides of Parliament come together and issue a bi-partisan report calling for action and further consideration of reforms. The Parliament is the voice of the Australian people and the gravity of the recommendations in the report should not be underestimated.

The AADA has in the past few years engaged in strong advocacy on the need for better protections for franchised new car Dealers in their relations with Manufacturers. We called strongly for the establishment of a standalone Industry Code of Conduct which took account of the unique circumstances in our industry. After much consultation and many inquiries, we have achieved a set of industry-specific regulations which sit under the Franchising Code. We are prepared to allow these protections to be tested and will support the current approach, although we are already seeing evidence of workarounds by the OEMs and believe there are urgent definitional amendments which are required to ensure OEMs do not escape their obligations under the Code.

The automotive franchising regulations need to be reviewed by mid-2023 and at that stage we should again consider whether there is a need for a standalone Automotive Code of Conduct. Particularly, if we have not addressed some of the key concerns plaguing the relationships such as insecurity of tenure, difficulties in indemnification and the prevalence of unfair contract terms.

We solely represent franchised new car Dealers but stand in solidarity with truck Dealers and others who are subject to very similar relationships and risks. There is no reason why these protections should not be extended to those Dealers.

Arbitration is a very important issue, and one need only look at some of the disputes we have had over the past 18 months and some of the disputes currently underway to understand how the current system denies Dealers a fair go. The pre-contractual arbitration model put forward in this discussion paper warrants further examination, but AADA believes it could be applied to the automotive sector and lead to a better process for negotiating agreements which are currently one-sided and provided on a take it or leave it basis.

There is also merit in working towards an industry-led solution on binding arbitration, and AADA is prepared participate in good faith discussions to achieve such an outcome. However, we do believe that we will need the Government to encourage such a process because offshore car Manufacturers have demonstrated little interest in voluntary industry-led mechanisms.

We would urge this consultation process to carefully consider the evidence presented by us and the Dealers of Australia.

James Voortman
Chief Executive Officer

Section 2

RECOMMENDATIONS

1. Maintain the current approach on automotive franchising, but change the definition of Motor Vehicle Dealership to capture all commercial elements of the Dealer/OEM relationship.

2. Review the need for a standalone Automotive Code of Conduct at post-implementation review of the automotive part.

3. The Government needs to closely monitor key issues, such as insecurity of tenure, OEMs offering different agreements on different models, unfair contract terms, indemnification under the ACL.

4. Extend automotive franchising protections to truck Dealers, motorcycle Dealers and farm machinery Dealers.

5. The Government should advance the issue of pre-contractual arbitration with further work on the applicability of this model to the automotive industry.

6. The Government has to play an active role in encouraging the industry to reach such an industry-led agreement on binding arbitration, similar to the model in the Grocery Code of Conduct.

STANDALONE AUTOMOTIVE FRANCHISING CODE

The most important consideration of laws regulating the relationship between Australian car Dealers and offshore car Manufacturers is that they are effective. The efficacy of addressing the power imbalance should be the key question when deciding whether to enshrine Dealer protections in a standalone Automotive Industry Code or in the automotive provisions of the Franchising Code of Conduct.

In the past, the AADA has been of the view that the commercial relationship between Dealers and OEMs is very different to most franchise relationships and as a result deserves a separate Code. However, over the years after various Parliamentary inquiries and Government consultation processes, the decision was made by Government to enshrine automotive-specific amendments in a part of the Franchising Code of Conduct. The AADA has generally supported this approach as it has addressed our concerns by providing industry-specific regulations. We have also come to see the benefit that this approach maintains consistency with the Franchising Code.

At present, the AADA favours maintaining the current approach. We believe both mechanisms are capable of effectively regulating the industry if they contain the right provisions, but we acknowledge that the current automotive part to the Code has only recently been put in place. There are, however, some urgent amendments required in the current set of regulations to ensure that the automotive part to the Code delivers on its intent of levelling the playing field between Dealers and Manufacturers.

REMAINING ISSUES OF CONCERN

The discussion paper has asked for 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. We make the following observations.

SEPARATION OF SERVICE AND PARTS AGREEMENTS

In the few short months since the automotive provisions of the Franchising Code were amended, we have become aware of one very concerning limitation of the current approach. We have seen instances of Manufacturers separating the agreements they provide to their Dealers. For example, an OEM generally provides a Dealer Agreement which covers vehicle sales, parts sales, sales of accessories and the service operations. However, we are now seeing examples of OEMs offering specific agreements for sales and separate agreements for parts and service.

Offering separate agreements calls into question whether the Service and Parts Agreement is in fact a Franchise Agreement. We have legal advice which suggests that a separate Service and Parts Agreement may not constitute a Franchise Agreement which in turn means that it is not captured by the automotive provisions of the Franchising Code.

This is an incredibly concerning development, which threatens to undermine the intent of the recently introduced regulations. It is well accepted that the relationship between Dealers and OEMs encompasses all the departments of a Dealership – new sales, used sales, service/ repair, parts, and accessories. All these areas are interrelated and part of the fabric of the Dealer/ OEM relationship. They are central elements of the power imbalance and it is crucial that OEMs don't exclude these areas from scrutiny simply by developing a series of separate agreements designed to allow the OEMs to escape their obligations under the Code.

We believe this clearly goes against the intent of the automotive part of the Code introduced in June 2020 and amended in July 2021. The legislation in a number of sections references aspects from the service and parts side of the business. Clause 46A (1B) talks about compensation from direct as well as indirect revenue as well as the costs of winding up the business. Clause 46A (2) references the buy back or compensation to the franchisee for spare parts and special tools. Again, clause 49 (2) mentions a plan for managing down spare parts and service and repair equipment, while clause 49 (3) mentions reducing stock of spare parts.

The intention of the automotive specific provisions was to offer protections to Dealers against the worst OEM excesses in all areas of the business, from vehicle sales to service and repair. The massive investment required by Dealers extends into the service department where the Dealer is mandated to build fit for purpose facilities and purchase expensive OEM approved servicing equipment and genuine parts (from the OEM). There are significant training requirements in the service department too and Dealers are required to hold a minimum number of parts.

Allowing OEMs to simply offer separate Service and Parts Agreements, in order to escape the obligations under the Franchising Code for this area of the relationship, will place Dealers and the significant investments they make at risk.

While there is an argument to be made that a standalone Automotive Code provides the added benefit of wider coverage other than just franchising issues, we believe a simple change to the definition of New Vehicle Dealership Agreement under Part 5 will resolve this issue.

We have provided a proposed definition below.

Section 5

Recommended Motor Vehicle Dealership definition:

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

b. includes a business of:

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

II. selling motor vehicle parts for motor vehicles sold by the business;

III. servicing and repairing motor vehicles sold by the business; or

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

TENURE

The AADA remains concerned that the issue of tenure has not been adequately covered in the current regulations. Insecurity of tenure demonstrated by agreements that span as little as one-year is the key underlying characteristic of the power imbalance between Dealers and Manufacturers. For a Dealer that is constantly facing the fear of being 'non-renewed' it is impossible to push back against unreasonable demands of an offshore Manufacturer.

Why would a Dealer sign a one-year agreement? The answer is often that a Dealer has invested significant capital and human resources over a long period of time into the brand. The Dealer feels an obligation (particularly in the case of a family business) to the business, its employees and their customers.

The Oil Code, which was developed to overcome a power imbalance between big businesses and the smaller businesses they deal with, has a mandatory minimum term of five years, plus an option of a four-year renewal. We believe a five-year minimum term is appropriate for our industry and would question the ethics and the motives of any Manufacturer not comfortable with providing a five-year agreement, given the investments Dealers are asked to make. For reference, in the US Dealer Agreements are perpetual and among other franchises in Australia it is common for them to be ten or even twenty-year agreements.

The automotive-specific amendments introduced on 1 July 2021 addressed the issue of tenure in Clause 46B which states that a franchisor must not enter into a franchise agreement unless the agreement provides the franchisee with a reasonable opportunity to make a return during the term of the agreement.

The AADA supports this clause, but we are concerned that it will be difficult to enforce in practice. Furthermore, we are already seeing clauses in Dealer Agreements in which the Dealer is forced to acknowledge that the term they are being offered represents a fair and reasonable opportunity for a return, when in reality there has been no opportunity to negotiate the length of the term.

Equally, we are concerned that the regulations around end of term obligations may further encourage shorter term agreements. Under those regulations, OEMs and Dealers are now required to provide a reason when they do not renew an agreement. They are also required to provide 12-months' notice if they intend not to renew an agreement. Unfortunately, the regulations allow the 12-month requirement to be waived if the agreement is for a period of less than 12-months, in which case the notice period is six months. It also reduces the notice period to one month if the agreement is six months or less. There is a real risk that this element of the regulations will result in OEMs offering shorter terms so that they can provide the shortest notice period possible.

A fixed minimum five-year term would establish a fair and reasonable standard. We expect to see many new Manufacturers enter the Australian market in the next few years and when they choose to partner with local businesses, they should be making a commitment commensurate with the investment being required of Dealers and the faith put in them by customers who expect to have the OEM provide support through service and repair for several years.

OEMs ISSUING MULTIPLE DEALER AGREEMENTS

The AADA is concerned with the practice which is emerging in Australia whereby OEMs are offering agreements specific to certain model lines. Commonly, a Dealer signs a Franchise Agreement and in return is given the opportunity to distribute all of the brand's range of vehicles approved for sale on the Australian market. However, we have started to see some brands now offering separate agreements for different vehicles. For example, Mercedes-Benz offered Dealers a separate agreement for the sale of its EQC electric vehicle types. This currently sees Mercedes Dealers selling all products under a traditional franchising model except for the EQC, which is sold under a separate Agency Agreement. There are several Manufacturers which are in discussions about moving to a similar approach.

The implication for this is that Dealers are pressured into agreeing to separate Agency Agreements on the basis that the vehicles covered by these agreements only constitute a fraction of the volume. The problem is that this process becomes one of OEMs introducing agency by stealth whereby Dealers are made agents for electric vehicles which may be selling in low numbers today but will likely constitute the bulk of volume in several years.

The worst-case scenario here is that an OEM puts a Dealer onto rolling one-year Agency Agreements (or less) for a certain model of low-volume vehicle and as the volume of that particular vehicle grows, so does the tenuous nature of the Dealer's situation.

While the enhanced disclosure regulations under the Franchising Code should offer Dealers a degree of protection on this issue, the problem is once again that Dealers are unlikely to enforce their rights because of the fears of losing their franchise.

UNFAIR CONTRACT TERMS

We note that the Government is currently addressing the issue of Unfair Contract Terms protections by preparing to introduce legislation expanding the number of businesses able to access these protections.

The AADA supports proposed expansion from businesses employing less than 20 people to businesses employing less than 100. Dealerships employing less than 100 people will now be covered by these protections and every Dealership in New South Wales will be covered under state-specific laws which offer Dealers protections against UCT in their agreements with OEMs. Nevertheless, many businesses outside of NSW will exceed the employee threshold and will not enjoy the protections offered by the UCT legislation. We have consistently said that these protections should be made available to all franchisees considering the major power imbalance that exists in our industry. Even Australia's biggest car Dealers are dwarfed by the size of the global car Manufacturers to whom they are franchised.

Section 9

INDEMNIFICATION

The power imbalance that exists between franchised new car Dealers and Manufacturers, inclusive of Importers, Distributors and Agents, gives cause to warranty and Australian Consumer Law (ACL) consumer guarantee arrangements that can lead to harmful consumer and Dealer outcomes. Not all franchisor OEMs employ such aggressive and unfair policies, but those who do place Dealers in a no-win situation which can result in Dealers losing their franchise and leave a trail of frustrated and dissatisfied customers with unresolved ACL claims.

Under Section 274 of the Competition and Consumer Act (2010), there is a requirement by Manufactures to indemnify suppliers (Dealers) for consumer guarantee claims made under the ACL. Despite this requirement, some Manufacturers - normally operating under the instruction of their overseas head offices - enforce their own warranty policies and procedures in this country without regard to the laws of Australia.

Some warranty policies and procedures are extremely administratively burdensome, set draconian procedural obligations and if scrutinised, are likely to be found in breach of the ACL. This creates a situation in which Dealers are frequently left with no alternative other than to cover the cost of the repair themselves or sublet repair work to external providers. These are often the only options available to Dealers who are fearful of receiving OEM funding clawbacks or losing their franchise agreements all together, while striving to satisfy customers and honour their claims.

Dealers attending to consumer guarantee claims are in a very difficult position. They are obliged to respond to ACL consumer guarantee claims while having no certainty that they will be compensated for their time and materials. Some Dealer Agreements go so far as to stipulate that all customer complaints be reported to the Manufacturer, who may choose to intervene and instruct the Dealer on how to respond.

In these circumstances, compliance with Manufacturer instructions by the Dealer is not optional and failure to do so can have dire consequences for the Dealer, despite the consumer guarantee obligations.

Most Dealer Agreements in Australia allow provision for warranty reimbursement based on agreed rates for labour and parts, which are significantly lower than commercial rates. Dealers agree to these conditions under sufferance as taken within the context of the entire agreement, they reasonably expect to be able to make up the shortfall in other parts of their business. This results in Dealers being barely able to break even on warranty repairs, even under ideal circumstances. Australian practice through the ACL and Competition and Consumer Act should seek to emulate statutory provisions like those in the US, where warranty and consumer guarantee work is reimbursed at normal retail rates. This covers the high costs incurred of employing technicians, warranty administration and complying with Manufacturer dictated diagnostic and repair functions.

The Australian consumer affairs ministers in 2019 agreed that a regulation impact assessment (RIS) should be undertaken on options to prohibit Manufacturers from failing to indemnify suppliers, and prohibit retribution by Manufacturers against suppliers who seek indemnification. The assessment will consider the costs and benefits of applying the options across all sectors of the economy, and to new motor vehicles only. We understand this RIS will be released in 2021 and we look forward to providing a detailed response.

OPTIONS FOR FURTHER SUPPORTING THE AUTOMOTIVE INDUSTRY

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

The AADA supports this option, provided that amendments are made as soon as possible to stop OEMs from separating their agreements so that some elements of the relationship are not captured by the Franchising Code. We support an amendment to include these protections to other franchised automotive Dealers. While we have mentioned a number of other issues we believe should form part of amendments we understand that these are either being addressed in other processes of Government or through alternative approaches in the current system.

Option 2: Establish a standalone Automotive Franchising Code

We believe the question of a standalone Automotive Franchising Code should be revisited when the post-implementation review of the automotive part of the Franchising Code is completed before mid-2023.

Are provisions needed to cover other vehicle types?

The discussion paper asks whether the automotive-specific protections should be extended to cover Dealers which distribute vehicles such as trucks, motorcycles and farm machinery. The paper mentions that limited evidence was submitted at the time to support expanding the scope beyond new cars. The AADA exclusively represents franchised new car Dealers, but we do have members that are also franchised truck Dealers and we support the extension of these protections to those Dealers. Dealers from those industries are all Australian-owned businesses in a franchise relationship usually with a multi-national Manufacturer. Many of the same brands which manufacture cars for sale on the Australian market are also making trucks and or motorcycles. Our understanding is that many of the behaviours are similar, many of the agreements are structured the same way and many of the risks carried by car Dealers are carried by truck, motorcycle, and farm machinery Dealers. We would advise the Government to act on this before a situation like the Holden withdrawal occurs in one of those industries.

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?

The most immediate problem we have identified is the option that may exist for Manufacturers to separate parts of the Dealer agreements they provide to their dealers. Offering separate agreements calls into question whether some of those separated agreements such as the service and parts agreement is in fact a franchise agreement as defined by the Code. This is clearly counter to the intent of the automotive regulations, and we would propose an immediate amendment to the automotive provisions of the Franchising Code, specifically the definitions of Motor Vehicle Dealership.

While we have listed a number of other areas of concern, we understand these are either being addressed in other processes of Government or through alternative approaches in the current system. We will continue to monitor them and discuss with the Government moving forward.

What evidence can you provide about the magnitude of the problem (i.e. quantitative and qualitative data)?

We reserve the right to discuss in private with the Treasury.

Which option do you consider to be the most effective solution and why?

The AADA supports the option of amending the Franchising Code and its automotive specific provisions when required. It is important that amendments are made as soon as possible to stop OEMs from separating their agreements so that some elements of the relationship are not captured by the Franchising Code.

Section 11

OPTIONS FOR ARBITRATION

One of the biggest failings of the Franchising Code of Conduct is the weakness of the dispute resolution process. The Code is meant to address a power imbalance between franchisors and franchisees, but it fails when these relationships break down and franchisees need a cost-effective, timely and determinative outcome. The Code affords parties to a Franchise Agreement options to resolve disputes through mediation or legal action through the court system.

We note the changes introduced to dispute resolution under the Franchising Code, including allowing for voluntary binding arbitration. Unfortunately, we remain sceptical that these changes will make much of a difference in the instances where an OEM is not interested in engaging in good faith mediation. Successful mediation relies on both sides coming to the table and working towards a fair resolution. There have been recent instances where car Manufacturers are not inclined to negotiate, particularly, when the local management is acting on instructions from the offshore head office. When mediation fails and franchisors are unwilling to settle the dispute through arbitration, the only option for franchisees is to either comply with the franchisor's terms or to seek redress through the court system.

The limits of dispute resolution were laid bare in the dispute between General Motors (GM) Holden and its Dealers when after mediation failed, the then Minister for Small Business, Michaelia Cash, wrote to both parties requesting they agree to settle their dispute via arbitration. While the Dealers agreed to participate GM bluntly refused, calling the Minister's request inappropriate and unhelpful.

Taking on a car Manufacturer in the courts is a grim proposition even for a well-resourced Dealer. OEMs have large internal legal departments, and their resources allow them access the best legal representation money can buy for as long as they need it. A court challenge can take years at great financial cost, a point OEMs have often made to Dealers considering such action. OEMs are only too aware of the reluctance of Dealers to challenge them through the courts and as a result there is very little incentive for them to engage in good faith mediation. There are currently two high profile cases of Dealers engaged in court action with OEMs. Both cases demonstrate the challenges of taking on a well-resourced multi-national corporation, as OEMs find ways to drag out the process.[1,2]

[1] https://premium.goauto.com.au/holden-moves-to-stall-class-action/
[2] https://premium.goauto.com.au/bizarre-letter-from-tokyo/

Option 1: Pre-contractual arbitration model?

The AADA supports further consideration of option 1 and considers the pre-contractual arbitration used in the Sugar Code as the preferred method. The AADA believes that there is merit in considering a system of pre-contractual arbitration for the automotive industry. The discussion paper points out 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. Such a model could work if applied at the level where the Dealer Council is negotiating with the Manufacturer on behalf of the whole Dealer network. Currently, all Dealers can collectively bargain with their Manufacturers and negotiate on the agreement. In the event that Dealers and OEMs are in dispute on key elements of the agreement, an arbitration process could rule on key sticking points. Currently, OEMs provide agreements with one-sided terms to their Dealers and are usually unwilling to negotiate. The ability to challenge a key term in an agreement could provide Dealers with a level of fairness at the start of the agreement.

Option 2: Arbitration model used in the Media Bargaining Code

Option one is preferred, largely because it does not require standalone legislation and can be included in the Franchising Code of Conduct. However, there may be merit in combining some elements from option 2 into the preferred option. It may be worth limiting the kinds of issues that can be arbitrated on. Issues, such as an appropriate length of the agreement, level of investment required and the existence of terms which may be in contravention of clause 6 (3a, Obligation to Act in Good Faith, Division 3). This is not a complete list and will require further consultation, but the point is that like the Media Bargaining Code, the issues to be arbitrated could be narrowed.

Option 3: Industry-led improvements to dispute resolution

There may be scope for an industry-led solution in which Manufacturers and Dealers agree to include binding arbitration in agreements as a final option to settle disputes. The AADA have previously cited the National Automobile Dealer Arbitration Program (NADAP) model in Canada, and while the situation is different in Australia, the principle of an industry-led solution is where the appeal in the NADAP model lies. The automotive specific provisions of the Franchising Code provide the rules and all that is required is for industry to agree on a mechanism to allow for binding arbitration to be included in Dealer Agreements. This could be a memorandum of understanding reached by peak groups and signed onto by the Manufacturers and Dealer Councils. AADA is prepared to engage in good faith discussions on a voluntary system of arbitration in which the Dealer could refer a dispute under the Code to an arbitration process. The key would be trying to get offshore multi-national companies to participate in such a voluntary scheme, where the evidence is that they would not be willing. The AADA would urge the Government to play an active role in encouraging industry to reach such an agreement.

Could pre-contractual mandatory arbitration enable better access to justice for Dealers in relation to resolving disputes?

AADA would need more detail on the pre-contractual mandatory arbitration system for the automotive industry, but there may be potential for such a system to improve the way in which Dealer Agreements are negotiated. Currently, these agreements are presented on a take it or leave it basis. Controversial terms are challenged by Dealer Councils and individual Dealers, but very seldom are significant changes made to the agreement. The ability to challenge a key term in an agreement will also provide Dealers with a level of protection. For example, if the Holden Dealers could have challenged the clause in their agreement which restricted them from taking on rival franchises, those Dealers would have been in a better position to diversify their business and protect themselves from the sudden withdrawal of the brand from Australia. Similarly, a Dealer or Dealer Council could challenge the ability of a one-year agreement to recover their investment or if they could challenge a term which may be in contravention of clause 6 (3a). This option is worth more consideration a means of achieving better access to justice for Dealers.

What types of contract terms could be best suited to a pre-contractual arbitration model?

Those that come to mind are the length of the agreement, the investment required, whether any term is fair or reasonable as required under clause 6 (3a) of the Franchising Code. Identifying which terms are best suited to pre-contractual arbitration would require a more detailed review of the Dealer Agreements and consultation with Dealer Councils.

What measures could be put in place to reduce any potential risks of adversely affecting the franchising relationship before the contract starts?

The fact that many agreements will be negotiated by Dealer Councils could prevent the relations between individual Dealers and OEMs from becoming fractured before the agreement even commences. There could also be some consideration of allowing the Dealers serving on these councils to have some respite by ensuring communication is through the Dealer Council's legal representative or other representative body.

CONCLUSION

We thank you for the opportunity to contribute to this important consultation process. We would welcome the opportunity to discuss this in more detail. If you have any questions, please contact me on:

James Voortman
Chief Executive Officer
M: [redacted]

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

E info@aada.asn.au

aada.asn.au