FCAI Response to Regulatory Impact Statement – Enhancements to Unfair Contract Term Protections

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Introductory Comments

1. The Federal Chamber of Automotive Industries (**FCAI)** is the peak industry body for the motor vehicle industry in Australia. Sales of new motor vehicles by FCAI members represent over 99 per cent of all new motor vehicles sold in Australia each year. The FCAI welcomes the opportunity to make this submission on the Consultation Regulatory Impact Statement (**RIS**), which it does so on behalf of its members. In this submission the FCAI will only address those matters which have specific relevance to its members.

2. The FCAI understands the reasons why the unfair contract term (**UCT**) protections were extended to small business in 2016. As explained in the Explanatory Memorandum to the amending Act:

   'The objective of this reform is to promote fairness in contractual dealings with small business with regard to standard form contracts'.

3. The FCAI points out that motor vehicle dealerships are in the main far from small businesses and are not in a vulnerable position vis-a- vis the manufacturers[1]. In fact, over 80 per cent of dealerships are part of a sophisticated conglomerate representing numerous separate dealerships. The largest of these - AP Eagers - with the recent takeover of AHG, owns almost 300 car, truck and bus dealerships and has a market capitalisation of in excess of $2 billion.

4. FCAI notes that in many cases, dealerships might call themselves 'family owned', but they are far from small business in need of UCT protections. All dealers require a level of financial means and business sophistication to be in a position to own and operate a dealership. They are not the 'mum and dad' operations that is sometimes suggested.

5. The FCAI would like to briefly address one point raised in the introduction section of the RIS: the suggestion by some stakeholders that the UCT protections should be extended to all automotive franchising agreements. Presumably this suggestion is sought to be justified on the completely outdated assertion that automotive dealers are unable to look after themselves when dealing with manufacturers. As explained above, automotive dealers are invariably (and increasingly) large sophisticated organisations which are more than capable of representing their own interests when negotiating with manufacturers. In any event, even if one does not believe that automotive dealers are not able to look after their own interests, the FCAI respectfully submits that the existing legal regime, including the existing UCT provisions, provide small business dealers with more than adequate protection.

[1] Throughout this submission 'manufacturers' has the meaning in the ACL

Chapter 4 - Legalities and Penalties

6. The FCAI sees no compelling reason to change the status quo (option one) although it can see that a limited strengthening of compliance and enforcement activities could be beneficial (option 2). Of the remaining options, the FCAI wants to respond to two in particular.

Option 3 - Making UCTs illegal and introducing financial penalties for breaches

7. Imposing financial penalties is a serious matter and should only be done if there is a demonstrated need and it is clear that the threat of imposing a penalty will reduce the unacceptable behaviour.

8. As far as the FCAI is aware, there have been no instances where UCTs have been found to have been used in the automotive industry. Looking more broadly, the FCAI accepts that there have been instances where UCTs have been used but queries the assumption made in the RIS that:

'*This option [imposing financial penalties] is likely to be the most significant deterrence against using UCTs in a small business standard form contract.*'[2]

9. Currently, the consequences of a company being found to have used standard form contracts which contain UCTs are significant. The UCTs will be found to be void and consequently will be unable to be relied on. The UCTs, by their nature, will be of benefit to the company and, given that they will be within a standard form contract, are likely to be widespread. The potential impact of companies being found to use UCTs are therefore already a more than sufficient deterrent.

10. In addition, the circumstances in which a penalty can be imposed should be clear. In the case of UCTs, this is not the situation. First, the contracting party needs to have fewer than 20 employees. As pointed out later, the number of employees a dealer may employ is often difficult to ascertain and in any event, can change over time. Second, the contract needs to be 'standard form' and in many cases what is meant by 'standard form' is ambiguous (as is acknowledged in the RIS). Finally, the term complained of needs to be found to be 'unfair'. This is highly variable, making it difficult to predict whether or not a term will be found to be unfair.

Option 4(b) regulator determinations

11. It has been suggested by some submitters to the review that regulators be given the power to determine whether a contractual term is unfair.

12. The FCAI sees no merit whatsoever in this suggestion. It agrees with other submitters that:

'*it would be inappropriate for regulators to take on the role of making determinations themselves, as the determination process of a contractual term is subjective and situational, demanding considerable interpretation and judgment, and therefore something that may be better undertaken by a court.*'[3]

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[2] At page 18
[3] At page 19 of the RIS

13. The FCAI also agrees with the point made in the RIS that:

'*the public nature of court processes and the detailed public judgments that are produced may act as a deterrent and as a guide for other businesses seeking to avoid UCTs*[4]

Chapter 5 - Flexible Remedies

14. The FCAI agrees that there are some concerns around the UCT regime when the only remedy available to a Court is to declare the UCT void. As pointed out in the RIS, there is the potential that a UCT once declared void, and therefore unable to be relied upon by a party, might mean that the small business is put in a worse situation than it was in when the unfair term was in the contract.

15. The FCAI supports option 2 – if a Court declares a small business contract term unfair, the term would not be automatically voided but the Court would have the power to determine appropriate remedies. Courts are used to crafting remedies that address the loss suffered by a complainant and the FCAI is confident that Courts would be able to do this in the context of UCTs.

Chapter 6- Definition of a small business

16. As an initial point it is important to note that in addition to the UCT provisions, businesses, be they big or small, have protections which, while not going quite as far as the UCT provisions, are nonetheless similar in nature. These include the unconscionable conduct provisions in the Australian Consumer Law (ACL), unconscionable conduct at common law, the obligation to act in good faith which is contained in the Franchising Code of Conduct and the duty to act in good faith which is increasingly being implied into contracts and business relationships in general.

17. Over and above these existing protections the UCT provisions offer additional protections to 'small' businesses. This means that it is the size of the business that is the determining factor in the apparent need for the UCT provisions – i.e. it is because the business is 'small' which in and of itself means that it needs to have the protections contained in the UCT provisions. As pointed out in the Discussion Paper:

'*Like individual consumers, many small businesses lack the time, resources, legal or technical expertise and bargaining power to negotiate changes to terms specified in standard form contracts'.*

18. In other words, the criteria used in the legislation needs to accurately distinguish 'small' businesses from other businesses. In the FCAI's view, the headcount test does not accurately do this.

[4] At page 20 of the RIS

Annual turnover rather than head count

19. The FCAI is of the view that it would be preferable to define a small business by reference to its business turnover in the previous financial year. In the new motor vehicle industry, turnover is proportional to size and it is a more transparent and straightforward measure. It would also address the following two concerns with the 'headcount' criteria.

- it can often be very difficult for a contracting party to be able to ascertain if it is dealing with a 'small business'. In the automotive space, employees can often be scattered across a number of sites and/or franchises and it is often not readily apparent which company is actually the employer; and
- the number of employees can fluctuate during the term of the contract. This could mean that when a party initially enters into a contract it was not subject to the expanded UCT regime but during the term this changes, unbeknown to the other party. A company's turnover from the previous financial year is a static and easily ascertained number which cannot subsequently change, giving more certainty to the contracting parties as to which laws will apply to the contract.

20. In the FCAI's view, a 'small business' should be one which has an annual turnover of less than $10 million. As pointed out in the RIS, this is consistent with the Australian Taxation Office, which uses an aggregated turnover of less than $10 million to categorise a small business for various tax concessions.

How should employee numbers for subsidiaries be counted?

21. If headcount is to be used, then the opportunity should be taken to ensure that the definition clearly includes employees of related bodies corporate. As pointed out in the RIS a company could technically be a 'small' business' because it has less than 20 employees, but as a part of a larger group of companies it can have access to sophisticated resources and the strength of the group. In these circumstances the business is anything but small and should not be able to avail itself of the protections offered by the UCT regime. This is particularly relevant in the new motor vehicle retailing industry where a single dealer group (eg AP Eagers) will often represent several franchise brands, but each individual franchise may be operated by a smaller subsidiary company and where further consolidation is currently happening.

Chapter 7- Contract value threshold

Upfront price

22. In the context of the automotive industry, the definition of 'upfront price' raises a number of unique uncertainties. These were comprehensively and frequently highlighted to the Government by the FCAI prior to the UCT provisions coming into force. FCAI has attached the previous submissions for ease of reference.

23. In essence there are two problems: The first is that dealers usually enter into a Dealer Agreement because they have purchased an existing dealership business

(of which the Dealer Agreement is the main asset). The incoming dealer pays the exiting dealer for the business. In many cases the consideration paid for the business will exceed the 'upfront price' but, as it is not, '*provided for the supply, sale or grant under the [franchise/dealer] agreement* ' it is not taken into account when determining the 'Upfront Price' of the franchise/dealer agreement.

24. The second problem arises because the value of orders placed by dealers on the manufacturer is not taken into account when determining the 'Upfront Price' of the dealer/franchise agreement – even though this is the essence of the agreement.

Chapter 8 – Clarity on standard form contracts

25. The FCAI agrees with many of the submitters to the RIS that it is often difficult to ascertain if a contract is a 'standard form contract'. In the context of the automotive industry this difficulty is exacerbated in circumstances where a manufacturer wants to introduce a new dealer agreement, or make significant amendments to an existing agreement. Generally, a manufacturer will engage with a representative group of dealers often under the auspices of the respective Dealer Council. These representatives don't have formal authority to bind the dealers, but they are the 'voice' of the dealers.

26. Generally, the manufacturer and the dealer representatives discuss and negotiate the draft dealer agreement, often over many meetings, with both sides being legally represented. As a result of these negotiations the manufacturer will amend, often substantially, the draft dealer agreement. At the conclusion of the process the manufacturer sends the final version of the new agreement to all dealers.

27. While this amounts to a substantial degree of negotiating on the terms of the dealer agreement, it is unclear whether, in this situation, the dealer agreement is a 'standard form contract'.

28. A further complication is that often there will be special conditions added to a dealer agreement. These special conditions are often negotiated with the dealer on an individual basis, with the 'standard terms' remaining unaltered.

Option 3 – clarifying 'effective opportunity to negotiate'.

29. For the reasons explained above, the FCAI supports option 3 - clarifying what is meant by 'effective opportunity to negotiate'. The RIS suggests that the clarification should be achieved by giving examples of the types of actions which do <u>not</u> constitute an 'effective opportunity to negotiate'. The FCAI believes that in addition to this, the matters currently listed in section 27 of the ACL which a Court can consider when determining if a contract is a 'standard form contract' could also be further clarified. For example, one of the matters is: '*whether the contract was prepared by one party before any discussion relating to the transaction'.* In the FCAI's view, this consideration should be amended so that it more clearly refers to prior discussions and negotiations with representatives of the other party.