



**FEDERAL
CHAMBER OF
AUTOMOTIVE
INDUSTRIES**

**FEDERAL CHAMBER OF
AUTOMOTIVE INDUSTRIES
SUBMISSION TO THE
REVIEW OF THE
FRANCHISING CODE OF
CONDUCT CONSULTATION
PAPER**

6 October 2023

GLOSSARY

AADA	Australian Automotive Dealers Association
ADR	Alternative Dispute Resolution
The Associations	The FCAI, AADA and MTAA
Dealers	Encompasses franchisees, dealers and agents
FCAI	Federal Chamber of Automotive Industries
Franchising Code or Code	The Competition and Consumer (Industry Codes-Franchising) Regulation 2014
Mercedes Case	<i>AHG WA (2015) Pty Ltd v Mercedes Benz Australia/Pacific Pty Ltd [2023] FCA 1022</i>
MTAA	Motor Trades Association of Australia
MVIS	Motor Vehicle Service and Repair Information Sharing Scheme
OEM	Encompasses automotive manufacturers and/or distributors and/or importers and/or franchisors in Australia
OHV	Off-Highway Vehicles

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1. EXECUTIVE SUMMARY

The Federal Chamber of Automotive Industries (FCAI) is pleased to participate in the 2023 Review of the Franchising Code of Conduct (the Code).

The Code is a key document that mandates general protections offered to franchisees. Since 2021, Part 5 of the Code has specified additional provisions relating to new vehicle dealership arrangements.

The Code has been the subject of a number of significant and comprehensive reviews over recent years, and has been subject to amendment ten times since it was first introduced in 1998.

While some amendments have been to the benefit of franchisees and franchisors alike, others have not been so positive. There is a real risk that continual amendment generates regulatory uncertainty and encourages parties to seek political solutions at the expense of considered changes based squarely on evidence and need.

For example, major amendments to Part 5 were only introduced in June 2021. Given the comparative newness of these amendments, their practical impact is yet to be seen throughout the sector. The circumstances that would cause the amendments to be utilised are yet to occur and the effect of the amendments will not fully flow through to the market until the existing dealership agreements expire and new agreements are negotiated.

Given the ongoing change to the mandatory Code and the significant impact such changes can have on the franchising parties, it is vital that any further changes to the Code are firmly evidence based, and designed to improve the operation of the Code and to reduce compliance burden for all affected parties.

As with any new policy and regulatory arrangements, observation of the actual impact in the market compared to the legislative intent is critical to good governance and the maintenance of positive consumer outcomes.

The competitive landscape within the automotive sector has evolved over time into a framework that provides a mix of retail solutions to meet consumer demands and will continue to do so in the future. History has shown that no matter the sector, disruption occurs, and change is certain. Competition is to be encouraged and businesses will innovate in order to provide solutions desired by consumers. New motor vehicle sales are no exception. The challenge is to ensure that the drivers of change are not artificially constrained or distorted which will inevitably lead to worse outcomes for consumers.

It is the position of the FCAI that:

- The Code is fundamentally fit for purpose. There is no need for the introduction of a stand-alone automotive code which would come at a significant cost to the industry, and ultimately to the consumer.
- The automotive specific elements of the Code should continue to only apply to new motor vehicle dealerships (as currently defined in the Code).

- The automotive specific provisions of the Code should not be extended to include the motorcycle and/or Off-Highway Vehicles (OHVs) sectors given that there is no evidence to justify the need for such regulatory intervention.
- An earlier proposal regarding pre-contractual arbitration will not assist the new vehicle sector nor the consumer and would in fact be counter to the recent changes.
- The implementation of US-style dealer legislative protection (as proposed by some dealer groups) would operate to protect the dealers' existing business model at the expense of Australian consumers and new market entrants, and would also create a two tier regulatory system divided by new versus existing automotive brands.
- The Federal Court has recently offered valuable guidance on settled legal principles relating to goodwill and its interaction with the Code.

In addition, the FCAI is proposing a range of minor amendments to improve the efficient operation of the Code. These amendments have been drafted by the FCAI in order to provide clarity, address unintended consequences or address market reality, and are included in Part 3 of this submission.

This FCAI submission is informed by the clear guidance provided by the Federal Court of Australia in *AHG WA (2015) Pty Ltd v Mercedes Benz Australia/Pacific Pty Ltd* [2023] FCA 1022 (the Mercedes Case).

This submission is structured as follows:

- Part 1 - General commentary
- Part 2 – FCAI responses to review questions
- Part 3 – Suggested amendments to automotive provisions within the Code
- Part 4 – Analysis of the interaction of settled legal principles and the automotive provisions of the Code (to be provided as a supplementary submission).

2. INTRODUCTION

The FCAI is the peak industry body for the Australian importers and distributors of passenger motor vehicles, SUVs, and light commercial vehicles, along with motorcycles and OHVs.

FCAI members supply about 99% of new vehicles to the Australian market each year. Members are listed at <https://www.fcai.com.au/about/members>.

New motor vehicle distributors and dealers provide the over one million Australians who buy a new car each year with access to more than 50 brands to choose from.

3. THE FRANCHISING CODE AND RECENT AMENDMENTS

The Code has been subjected to significant Government and Parliamentary consideration. These inquiries and reviews have led to some improvements in transparency and understanding for

franchisees (also referred to as dealers in this submission) and franchisors (also referred to as OEMs in this submission).

However, the Code has now been amended ten times since 1998. This continual ongoing amendment has caused a large degree of regulatory fatigue and has at times imposed unnecessary compliance burden on OEMs.

Some of the recent amendments include:

- In the case of an agreement with a term of more than 12 months, the requirement for 12 months' notice of intention to renew or not to renew with the latter requiring a statement of reasons.
- Pre-contractual disclosure of capital expenditure requirements.
- An augmented dispute resolution process and the added capacity for conciliation as well as mediation and voluntary mandatory binding arbitration.
- Multi-party Alternative Dispute Resolution procedures.
- A requirement for more information to be provided to prospective franchisees at least 14 days before entering into an agreement.
- The development and provision of a Key Facts Sheet (in addition to the Disclosure Document) to be provided to the prospective, renewing or transferring franchisee at least 14 days prior to any agreement.
- Additional information to be provided in the disclosure document including whether the agreement provides for arbitration of disputes and also the franchisee's rights to any goodwill they have generated.
- Significantly greater degree of discussion and disclosure of any capital expenditure requirements.
- From November 2021, the inclusion of any earnings information with, or attached to, the disclosure document.
- Extension of the cooling off period to 14 days.
- Addition of a cooling off period for transfer of agreements.
- The franchisee can propose early termination of the agreement.
- The franchisor must give 7 days' notice of the proposed termination of the agreement on particular grounds, and the franchisee can dispute the termination in which case the franchisor cannot terminate the agreement within 28 days.
- For new motor vehicle dealership agreements, the previous voluntary best practice principles introduced in June 2020 became mandatory from 1 July 2021. These include:
 - Agreements must provide provisions for compensation for franchisees in the event of termination prior to expiry due to the franchisor withdrawing from the Australian market, rationalising its network in Australia, or changing its distribution models in Australia
 - Agreements must specify how the compensation referred to above is to be determined, with specific reference to the following:
 - lost profit from direct and indirect revenue
 - unamortised capital expenditure requested by the franchisor
 - lost opportunity in selling established good will
 - costs of winding up the franchised business

- Agreements must not include provisions that exclude compensation
- Agreements must provide a fair and reasonable opportunity to make a return on the investment required by the franchisor as part of entering into or under the agreement
- Agreements must include provisions for buy back of inventory and special tools where an agreement is subject to non-renewal, or termination prior to expiry occurs due to one of the events mentioned in dot point one above
- Agreements must include provisions for dispute resolution.
- Reforms which increased certain penalties available under the Code to the greater of \$10m, three times the benefit obtained, or 10 per cent of annual turnover.

On any assessment, these are significant changes where in many instances the full effect is yet to be observed.

The FCAI is firmly of the view that to recommend legislating further changes, in light of the lack of observation of the impact of the above amendments, is not only premature, but is also not driven by any evidence of market failure.

It is noted that in addition to the above amendments to the Code, the *Treasury Laws Amendment Act (No. 6) 2021* (Cth) imposes significant increases in penalties for “wilful, egregious and systemic breaches” of the provisions of the Code.

4. CONSUMER FOCUS

Regardless of the focus of any regulatory review there is a single imperative that must underpin any recommendations – consumer benefit.

Australians have choice in how they buy clothes, electronics and even real estate and want the same choice when buying a new car. They also recognise that limiting these options has only one outcome – higher prices, or in economic terms a reduction in consumer surplus.

FCAI has commissioned an economic analysis of the new passenger and light vehicle sector taking into account the recent changes to the Code and the potential impacts of yet more regulatory change. It is attached to this paper. As can be seen, there are very significant consequences if the Government moves to impose further unwarranted protections on new motor vehicle dealers. This analysis acknowledges that the amendments to the Code to date have been about better ensuring the value proposition for automotive dealers, and that some of the more extraordinary demands as yet unrealised, from the AADA in particular, would simply serve to limit competition in the market and increase prices.

Findings of the analysis include:

- The changes made to the Code in 2021 in response to GMH leaving the market and the resultant early termination of dealer agreements have addressed the consequences of this extraordinary event.
- Any further increase in protection of the traditional dealership model will lead to an increase in costs to consumers.
- Further restrictions risk stalling the flexibility necessary in a rapidly changing market needing to match consumer expectations in order to maintain satisfaction and competitive edge.

The analysis carefully considers the recent changes to the Code and the rhetoric around the apparent desire for yet more protection, and concludes that:

“.....any further restrictions on whether franchisors can treat freely in the market would reduce the pool of potential franchisees, protecting dealers, but inevitably leading to higher new vehicle costs in Australia.”¹

And:

“Restrictions such as minimum terms will reduce the flexibility of a rapidly evolving industry needing to meet consumer expectations of innovation not only in product lines, but in models of consumption. This will come at a cost to consumers, but potentially also to dealers and manufacturers, who will lack the capacity to respond to new market entrants and emerging trends”²

When considering consumer benefit, it is of equal note to consider the wider economy and the innovation and changes taking place.

There is disruption in all sectors, including the new motor vehicle sector³, yet it would appear that the new motor vehicle dealers are trying to position themselves as a protected species beyond the reach of innovation and change in the market, including change driven by consumers.

The Federal Government has for many years noted the benefits of change and actively promoted innovative manufacturing and service delivery. The economic efficiencies that have consistently increased the national product through a focus on releasing, not constraining, market forces should not end here.

While clearly there is a role for regulation in respect of, for example, community safety, there is no evidence supporting a major shift in policy driven regulatory development in relation to sale of consumer goods, and yet more change would simply extend the already significant protections available to all franchisees through the Code, and in particular new motor vehicle dealers.

¹ Federal Chamber of Automotive Industries: Economics of Automotive Franchising in Australia Prepared by Evaluate, 9 September 2021 (updated October 2023) page 14

² Ibid, page 3

³ For example, the introduction of EVs, internet-based selling, showrooming by customers, etc.

5. IMPACT ON THE CONSUMER OF OVER REGULATION

The FCAI believes any proposed new additional regulations will disproportionately benefit one component of the supply chain over the consumer.

The economic analysis by Evaluate states that the Federal Government has already found an appropriate balance between ensuring the capacity for a fair return on a motor vehicle franchise and allowing the market to operate competitively for consumer benefit. Code changes made in 2020 and 2021 provided further protections and there continues to be a lack of evidence on the impact on those changes and any general evidence that would warrant the consideration of any further regulatory protections.

The automotive retail environment is changing, consumers are changing but some large corporate dealer networks seem to be seeking to entrench the traditional automotive dealer model through further regulation that would subsequently increase barriers to retail innovation and change and ultimately increases costs to consumers. The suggestion of carbon copying US-style regulations is an ambit claim by dealer organisations to entrench existing dealer business models at the expense of Australian consumers and stifle retail innovation.

With choice comes the ability for consumers to pick brands that best cater to their preference, whether it be to purchase directly from OEMs or through dealers. As in other retail sectors customers are spending more time than ever online prior to arriving at the dealership and have often narrowed selection down to a handful of cars they want to test drive prior to deciding.

OEMs and dealers that innovate to cater to spending more time with each customer compared to traditional approaches will have advantage here. Research indicates that young people are happier not to negotiate on price and will make decisions based on other factors (experience, specifications, loyalty, social media, etc.).

Regardless, dealers will remain an important point of contact for consumers, including for after sales services and parts in which they earn much of their profit. While the gross profit orientation has shifted significantly through the COVID years driven by vehicle shortages, it is yet to be established if this change to the increased profitability derived through new car sales is an ongoing trend. In 2023, the industry has seen significant supply constraints lift with associated stock levels increasing and discounting return to the market in some segments.

The following table indicates the shift in gross profit elements over the period 2019-2023.

SELLING GROSS PROFIT ORIENTATION					
	2019	2020	2021	2022	2023 H1
New Cars	4%	14%	36%	43%	42%
Used Cars	8%	16%	13%	10%	7%
Finance and Insurance	20%	17%	12%	12%	13%
Parts	23%	17%	13%	13%	14%
Service	45%	36%	26%	23%	24%

Source: Deloitte Profit Focus industry data, 2023

Further as highlighted in the previous review in 2021, any proposal to introduce further regulation is directly contrary to the Treasury's stated objectives in the delivery of the economic agenda which expressly provides that *"Our legislation program is managed efficiently to reflect the Government's priorities and the laws we prepare are legally robust, and we have a low tolerance for creating unnecessary burdens on, or creating uncertainty for, regulators, industry and consumers."*⁴

To better understand Australians' views on the relationship these issues, the FCAI commissioned JWS Research in 2021 to explore the views of new car buyers in metropolitan and regional areas and their attitudes towards further regulation of the car purchasing process.

Australians have become accustomed, even expectant, of having choice when purchasing goods and services. The way we buy products and services has evolved considerably over the past decade, from online shopping and different payment options such as Afterpay, to increased choice of purchase channel or method, such as through the introduction of platforms such as Uber (transport) and Airbnb (short-term accommodation), use of online comparison tools such as Compare the Market (health insurance) and WebJet (flights), and consumer adoption of delivery of goods that would previously been confined to in-store collection, such as The Iconic (fashion) and Coles Online (groceries).

Consumers, and particularly younger consumers, recognise the many advantages of this evolution, with the top benefits resulting from the changes to the shopping experience over the past decade identified as:

- Choice of products / services
- Ability to get the best product for your needs
- Choice of providers
- Access to product / service information
- Easy, 'hassle-free' shopping experiences; and

⁴ The Treasury Corporate Plan 2021 - 2022 at page 11.

- Competitive pricing.

The comment below is a clear reflection of the consumer's perspective on regulating choice of retail model:

"It's anti-competitive, plus also almost all industries are going through their shake-ups right now. You have Airbnb shaking up the traditional hotel models, Afterpay shaking up the banking credit card models. Why should car sales not be open to that kind of shake up as well? Everything is going through a shake up right now, why should we stifle one area where the consumer could possibly benefit?" (Metropolitan New Car buyer)

Overall, Australians are relatively comfortable and satisfied with the current way of purchasing new cars through the traditional dealership model, however there is interest in and support for alternative sales models they have, in most cases, yet to experience.

Most Australians support OEMs choosing the sales method they use to sell cars, allowing them to adapt to changing economic conditions and consumer preferences, rather than having the Government regulate which sales method car makers can use.

For the most part, customers do not support the idea of locking in one sales model. Immediate reactions are that doing so would be anti-competitive and diminish consumer choice. It is recognised that many similar industries have evolved in ways that seek to benefit consumers and regulating the new car industry from doing so would limit consumer choice and benefits. If dealers and OEMs are not prevented from evolving, then this is a natural part of being in an innovative industry in the modern market.

"I don't think that the status quo needs to remain just because that's been the status quo. If there's a little shake up to the industry because that's what consumers want, then surely the consumers are the ones who dictate how that proceeds because they're the ones buying the products. So, you can't tell me how I want to buy something. Suck it up." (Metropolitan new car buyer)

Furthermore, the consumer research found that the co-existence of sales models offers real choice to Australian consumers and these consumers do not support regulation that locks or inhibits innovation to the detriment of the consumer:

- The most important benefit of OEMs being able to choose which sales model they use will be providing choice to Australian consumers (63% total agreement).
- Consumers also support choice of sales model for OEMs, because they agree that competition between OEMs will keep Australian car prices competitive, regardless of the sales method allowed (61% total agreement) and because the presence of different sales methods (e.g., traditional, agency and direct) will create better competition in the market and therefore lower pricing for customers (53 % agree).

- There is low agreement that dealers offer consumers the best available price (35% total agreement).

The concern of OEMs is that the potential for over-regulation from a standalone code and pre-contractual arbitration is real. Further regulation risks creating an inequitable two-tier regulatory system. The first, with a higher regulatory burden, would apply to the traditional sales models. Due to the significant costs in complying with this over-regulation there would be an incentive on companies to adopt a range of other sales models which would not be subject to these costs.

This has already occurred in the US as companies look to find ways of competing and innovating to meet the needs of consumers outside the dead hand of unnecessary and inefficient regulation which rewards dealers over consumers.

6. THE AUTOMOTIVE RETAILING SECTOR IN DETAIL

All too often those who seek to promote the need for an entrenched right to a dealership agreement use emotive (but inaccurate) terms to describe Australian dealerships, e.g. small business, family owned. In truth, the vast majority of dealerships are far from the simple small businesses often associated with the franchising sector. Dealership ownership is becoming more concentrated and increasingly dominated by sophisticated investors, whether they be family-owned conglomerates or, as is the case more and more recently, listed companies. These investors are rapidly purchasing dealerships across the country and have turnovers dwarfing many of the FCAI members. In some cases, such dealers can have a significant impact on other aspects of the vehicle supply chain including logistics distribution, etc.⁵ Increasingly, dealers are using artificial intelligence as another way to increase the sophistication of their operations with everything from predicting trends, personalised marketing and customer interaction.⁶

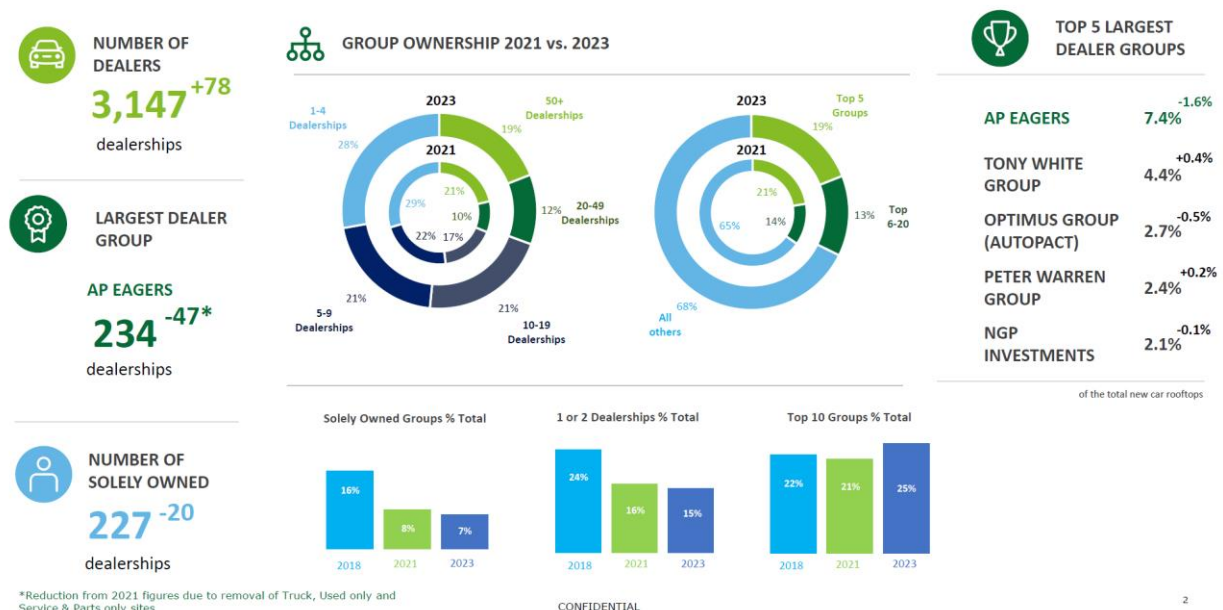
If it is the intention of the Government to embed protection for multi-million, if not billion, dollar businesses, then that should be made clear to the public. FCAI data shows that the industry is concentrated to the extent that the notion of a single site or small family business is succumbing to the bidding of cashed-up sophisticated investors, usually other dealership groups. Recent research, conducted on behalf of the FCAI by Deloitte, indicates the current make-up of the industry, as reflected in the graphic below.⁷

⁵ See for example, [Eagers expands BYD agreement \(goauto.com.au\)](https://www.goauto.com.au/news/2021/05/11/eagers-expands-byd-agreement)

⁶ See for example, [How AI is revolutionizing automotive sales and marketing \(cbtnews.com\)](https://www.cbtnews.com.au/news/2021/05/11/how-ai-is-revolutionizing-automotive-sales-and-marketing)

⁷ Source: FCAI Dealer Ownership Summary PPP, May 2021, updated in October 2023

SUMMARY DASHBOARD 2021 vs. 2023



What this table shows is:

- There are fewer and fewer single site dealers as the big groups buy them and consolidate the market.
- There is an overall trend to corporatisation, and this trend is accelerating (notwithstanding increased profitability of dealers and OEMs during COVID).
- The average turnover of an urban dealer is over \$97m a year.
- As noted in the Evaluate paper, “If anything, small businesses are on the decline, with market share of 1-2 dealerships declining from 24 to 16 percent over the 3 years to 2021. On the whole, the industry has become increasingly corporatised and consolidated.”⁸

FCAI has additional data on the actual make-up and concentration of the dealership network and can provide that if it would be of assistance. The data comprehensively debunks the ‘family-owned business’ myth.

7. REVIEW QUESTIONS – GENERAL

Question 1 - Are there any general observations you want to make about the regulatory framework?

The Code was introduced in 1998 and has been amended 10 times since. Constant review creates regulatory fatigue, stifles the potential for industry solutions and impedes the evaluation of the effects (either positive or negative) of previous Code amendments.

⁸ Evaluate, ibid, page 14

The Code needs improvement in some areas, as the compliance burden and prescriptive nature of the regulation is excessive. This could occur without impacting on the intent of the Code, or the protections it provides. Suggested amendments are proposed in part 3 of this submission.

Furthermore, in relation to the automotive sector, the FCAI's response can be simply stated as follows: there were no significant problems or issues being faced by the automotive sector prior to the Government's recent reforms, but if there is any doubt about this, those doubts were more than adequately addressed by the 2020 and 2021 reforms.

The suggestion that there were problems stems from a proposition that there is an inequality of bargaining power between the OEMs and dealers which is unfairly exploited by the OEMs.

First, there is no inequality of bargaining power. The FCAI made this point in its submission to the Parliamentary Inquiry into the Operation and Effectiveness of the Franchising Code of Conduct. Since that submission, the FCAI has obtained updated advice on the actual ownership structures and conglomeration of dealerships. It indicates that dealer consolidation is rife with fewer than 16% owned and operated as a single new motor vehicle dealership.

The market is dominated by new vehicle dealers that own five or more new car dealerships. The concept of a one sided or unfair arrangement, as perpetuated by repeated references to "family" businesses, is far from the norm for the sector. These 'family' businesses are often substantial businesses; take the Sutton Group for example, which has a turnover in excess of \$1billion.

Even at its most basic, a motor vehicle dealership is substantially more complex than a "standard" franchise and requires a more sophisticated person to run and manage it. A motor vehicle dealership is multi-dimensional: there is the purchase and sale of new and used vehicles, providing finance and insurance to customers, servicing and repairing vehicles, and selling parts, salespeople and technicians need to be employed and managed, stock inventory needs to be controlled. Most franchises are one dimensional: selling the goods or services provided by, or licensed to, the franchisee. Motor vehicle dealers must possess business acumen and experience to manage their sophisticated operations. Many have in house counsel. All have access to independent legal advice. As such, they are more than able to look after themselves when dealing with the OEMs.

In fact, the Productivity Commission Draft Report on The Right to Repair⁹ made a similar observation when considering the potential need to revisit the definition of consumer under the Australian Consumer Law. It concluded that large private enterprises are more than capable of accessing the expertise necessary to manage the complex range of challenges in running a small business, and if considering purchasing a \$600,000 new machine for a large farming enterprise they would conduct their own due-diligence. FCAI sees no reason to release new motor vehicle dealers from a similar obligation.

⁹ Productivity Commission, Right to Repair, Draft Report, June 2021, p79.

If there was any doubt about there being an inequality of bargaining position, this was laid to rest by the ACCC authorising a class exemption from 3 June 2021. This improves and simplifies access to collective bargaining for franchisees when negotiating with franchisors.

Second, there is no unfair exploitation of dealers by OEMs. Putting to one side the lack of any credible evidence which demonstrates this, it is just not in the interests of an OEM to do so. The Australian automotive market is one of the most competitive in the world and the OEMs need a strong and viable dealer network to compete.

Finally, if there was ever any doubt about OEMs exploiting their dealers surely it has been addressed by the many reviews that have been conducted into the Australian automotive industry. Every conceivable issue has been examined and reviewed, often multiple times. In the 2020 and 2021 there has been the introduction of:

- an automotive part of the franchising code;
- best practice automotive principles;
- a new mandatory scheme for the provision of motor vehicle service and repair information;
- a significant increase in the penalties for breaches of the Code (in some instances to \$10m); and
- an increase in the reach of the small business unfair contracts regime.

And on top of all of this has been the recent significant amendments to the Code that specifically relate to new vehicle dealer agreements effective from 1 July 2021. Without going through these amendments in detail it is worth making one point: in what other industry is a party to a contract required to actively look after the interests of the other party (who is entering into the contract willingly) or face the prospect of a fine of more than \$60,000 - as is the case in the new clause 46B of the Code? The answer is none.

The general and specific protections of the Code as they relate to a motor vehicle dealership agreement are comprehensive even though the relationship between the OEM and the dealer may not meet the feature requirements features outlined in the Code and in most instances do not.

Question 2 - Is the Franchising Code fit for purpose? Should it be retained? If so, should it be remade prior to sunseting?

The FCAI believes that the Code is fit for purpose and should be retained. The FCAI recommends that no further regulation burden should be imposed on the relationship between automotive OEMs and their dealers. As highlighted above and in the attached economic study there is significant risk to over regulation on the broader community.

The operation of the Code could be improved through fine tuning and suggested amendments have been included in Part 3 of this Submission.

Furthermore it is appropriate that the automotive sector remains in the Code. The FCAI is opposed to the creation of a stand-alone automotive industry Code.

The concern of OEMs is that the potential for over-regulation from a standalone code and previously proposed pre-contractual arbitration is supported by evidence. Further regulation

risks creating a two-tier regulatory system. The first, with a higher regulatory burden, would use traditional sales models. Due to the significant compliance costs which have come with the over-regulation of franchising, the second would incentivise companies to use a range of other sales models including new OEM entrants prioritising direct sales models.

This has already occurred in the EU, the US and other markets as companies look to find ways of competing and innovating to meet the needs of consumers outside of unnecessary and inefficient regulation which rewards dealers over consumers.

Question 3 - Are there any emerging trends, such as technology or cultural innovations, which would affect the operation of the Franchising Code?

Trends associated with the general provisions of the Code

In relation to the general provisions of the Code the review should consider that paperless transactions need to be better facilitated by the Code, as they create significant efficiencies and are preferred by most franchisors and franchisees. Currently the size of disclosure documents, notable the need to include lists of franchises and annex numerous documents, impedes proper disclosure by digital means.

The FCAI also recommends allowing flexibility in relation to electronic disclosure.

Trends associated with the automotive industry

The automotive industry is currently undergoing arguably the greatest change globally in more than a hundred years. The transition to low or no tailpipe emissions automotive technologies such as electric vehicles, driven by major market climate change regulations, are changing the relationship dealers and OEMs have with their customers. This shift is fundamentally changing the businesses of OEMs and dealers and their relationships with consumers and the products and services that they require.

The go-to-market strategy of OEMs broadly falls into six categories being:

- Traditional automotive franchising model
- Hybrid traditional automotive franchising model – single dealer group as delivery and service agent
- Agency
- Dealer facilitated agency.
- Direct to market; and
- OEM-owned dealership in conjunction with a traditional dealer network.

While the traditional automotive franchising model remains the dominate go-to-market strategy there have been an increase in the direct and hybrid business models especially from new entrants and EV-only brands.

It is important that the automotive sector and any consideration of future franchising regulation takes this into account. Over regulation will stifle retail innovation in established brands to the benefit of new entrants. This is not in the long-term interest of the dealers, OEMs and consumers.

The other major trend that should be taken into account with any consideration to automotive franchising regulation of the new vehicle sector is the continuation of the consolidation and corporatisation of dealers in Australia. This has resulted in increased bargaining power of the dealers as well as their increased level of sophistication and capital availability.

FCAI has commissioned an economic analysis of the new passenger and light vehicle sector taking into account the recent changes to the Code and the potential impacts of yet more reform. It is attached to this paper.

Further restrictions risk stalling the flexibility necessary in a rapidly changing market trying to match consumer expectations and compete with an ever-increasing number of competitors in the market.

The report acknowledges that the amendments to the Code to date have been about better ensuring the value proposition for automotive dealers, however some of the more extraordinary demands from dealer representatives would simply serve to limit competition in the market and increase prices. Findings of the report include:

- The changes made to the Code in 2021 in response to GMH leaving the market and the resultant early termination of dealer agreements have addressed the consequences of this extraordinary event.
- Any further increase in protection of the traditional dealership model will lead to an increase in costs to consumers.
- Further restrictions risk stalling the flexibility necessary in a rapidly changing market trying to match consumer expectations.

The report carefully considers the recent changes to the Code and the rhetoric around the apparent desire for yet more protection, and concludes that:

“.....any further restrictions on whether franchisors can treat freely in the market would reduce the pool of potential franchisees, protecting dealers, but inevitably leading to higher new vehicle costs in Australia.”¹⁰

And:

“Restrictions such as minimum terms will reduce the flexibility of a rapidly evolving industry needing to meet consumer expectations of innovation not only in product lines, but in models of consumption. This will come at a cost to consumers, but potentially also to dealers and manufacturers, who will lack the capacity to respond to new market entrants and emerging trends”¹¹

When considering consumer benefit, it is of equal note to consider the wider economy and the innovation and changes taking place.

¹⁰ Federal Chamber of Automotive Industries: Economics of Automotive Franchising in Australia Prepared by Evaluate, 9 September 2021, updated in October 2023, page 14

¹¹ Ibid, page 3

There is change in all sectors, including the new motor vehicle sector, yet it would appear that the new motor vehicle dealers are trying to position themselves as a protected species beyond the reach of innovation and change in the market, including change driven by consumers.

The Federal Government has for many years noted the benefits of change and actively promoted innovative manufacturing and service delivery. The economic efficiencies that have consistently increased the national product through a focus on releasing, not constraining, market forces should not end here.

While clearly there is a role for regulation in respect of, for example, community safety, there is no evidence supporting a major shift in policy driven regulatory development, and yet more change would simply extend the already significant protections available to all franchisees through the Code, and in particular new motor vehicle dealers with the additional annex.

8. REVIEW QUESTIONS - THE SCOPE OF REGULATION

Question 4 - Does the general scope of coverage of the Franchising Code remain appropriate? Is the scope of coverage flexible enough having regard to the diversity of the franchising industry?

The FCAI believes that the general scope of coverage of the Code remains appropriate. The Code currently deems motor vehicle dealership agreements to be franchise agreements even though in many cases they do not meet the test. The FCAI does not propose amendment to this position.

Question 5 - Have the amendments regarding the exclusion of cooperatives from the provisions of the Franchising Code effectively clarified that they fall outside the scope of the Code?

The FCAI is not able to comment on the exclusion of cooperatives from the provisions of the Code as it is not relevant to the automotive or motorcycle industries in Australia.

Question 6 - What evidence is available to suggest additional protections in the Franchising Code for new car dealerships should be extended beyond new car dealerships (for example to truck, motorcycle and farm machinery dealerships)?

The FCAI membership includes the majority of motorcycle and OHV manufacturers and distributors in Australia. The FCAI represents vehicles manufacturers below 3.5 tonnes, as such we do not represent large trucks and agricultural machinery manufacturers or distributors and are not able to comment in relation to those sectors.

The FCAI is not aware of any evidence that would call for the need to expand the regulation of motorcycle franchise agreements beyond the general Code.

In addition, it should be noted that motorcycle dealerships are significantly different from automotive dealerships. The key differences include:

- Capital requirements are relatively small. They rarely approach or exceed \$0.5m and are often a fraction of that amount, driven in part due to the product size, required floor footprint, branding requirements and logistics requirements.
- Similar to the fixed capital requirements, it is noted that the working capital requirements of motorcycle dealerships are also quite different to those of automotive dealers.
- Members have informed the FCAI that the total cost of taking on a franchise of an established brand can be as low as between \$10,000 to \$20,000, with fit out of and external signage being in the range of \$15,000 to \$25,000. To put this into perspective an automotive dealership fit out costs on average can range between \$2m and \$7m.
- It is highly unusual for a motorcycle manufacturer to require investment in new infrastructure or buildings. Dealer facilities are rarely purpose built and can be easily repurposed, both in relation to other motorcycle brands, or to be used for completely different business opportunities outside motorcycle retailing.
- Footprint size and capital outlay for workshops are a fraction of other mobility related products such as cars.
- Motorcycle dealers are overwhelmingly multi franchised with other bike brands, and in many instances, with other products such as gardening and home maintenance equipment. Motorcycle manufacturers do not require a separate building for the display and sale of new motorcycles. This diversification of product lineup ensures that the dealer is able to reduce their reliance on just one brand or product and as such able to spread their risk more so than with cars.
- Motorcycling is predominantly a discretionary purchase and, in many cases, a leisure pursuit. Of total motorcycle sales 55% are off road and OHVs and about 50% of those are unregistrable products. These vehicles target a very different consumer such as farmers in the case of 4 wheel product, and not dissimilar to boating and other hobbies in the case of minibikes and other off road motorcycles.

The FCAI encourages the independent reviewer to think carefully before recommending the inclusion of motorcycles in the coverage of automotive specific elements of the Code.

Importantly, the FCAI notes that there has never been any research nor regulatory impact statement of the motorcycle and OHV sectors to determine if there is indeed any market failure demanding a regulatory response.

It is the FCAI's position that there needs to be solid evidence presented why this additional regulation is required other than the convenient argument that motorcycle dealers sell mobility solutions with wheels and as such should be treated like automotive franchising. It is important not to confuse the isolated commercial dispute, that is in any event covered by the general franchising code, with evidence a systemic failure in the franchising code that calls for need of further regulation between motorcycle manufacturers and dealers that will increase bureaucratic burden and cost to consumers.

The attached FCAI commissioned economic analysis found that: There is no strong argument for including motorcycles in Part 5 of the Code.¹²

Question 7 - Should agreements between automotive manufacturers and dealerships that relate only to service and repair work (which do not cover matters relating to vehicle sales) be considered as franchise agreements and covered by the Franchising Code protections? Why or why not?

The FCAI does not support the inclusion of agreements between OEMs and dealerships that relate only to service and repair work (which do not cover matters relating to vehicle sales) into the purview of the Code.

The automotive specific elements of the Code were specifically designed to address the franchising relationship associated with the sale of new cars. This occurred as the automotive service and repair relationship is substantially different from new car sales.

In relation to service and repair work the OEM requirements are significantly different in relation to capital requirements and other agreement obligations. Often the facilities are separate – so the capital requirements are significantly less than for a showroom and there is less OEM branding attaching to the repair function. In addition, if the dealer is multi-franchised it is not unusual for several brands to be serviced out of the same service facility.

Service and repair only arrangements come in many different forms. Those undertaking services and repair include independent specialist service and repair businesses that are not linked to any automotive brand. In addition, a significant number of service and repair businesses already service vehicles from multiple brands and this is likely to increase. Similarly, future motor vehicles may require different service and repair capabilities.

The importance of this revenue opportunity to the dealer should not be justification for the broadening of the Code, rather the test should be what is the market failure that the regulatory change was designed to address. In this aspect of the OEM dealer relationship we see no justification for further regulation. In fact, extending protections appears contrary to the spirit and intent of other regulations such as the Motor Vehicle Service and Repair Information Sharing Scheme (MVIS) that aims to increase competition and consumer choice.

The FCAI does not believe service and repair agreements should automatically be deemed to be franchise agreements for the purposes of the Code. Rather the general definition of a ‘franchise agreement’ should apply.

Indeed, even in the situation of a brand exiting the market there remains the opportunity for dealers to continue to profitably service the existing car parc and as such the risk associated with service and repair operations and investment for dealers is diminished. The FCAI notes that many Holden Service Centres continue to operate even though GMH has exited the market.

¹² Page 4, Federal Chamber of Automotive Industries: Economics of Automotive franchising in Australia
Prepared by Evaluate 4 October 2023

Question 8 - Has the amended definition of motor vehicle dealership effectively clarified that agency sales models remain within the scope of regulation under the Franchising Code?

The amended definition of motor dealer vehicle dealership has effectively clarified that the agency sales model is within the scope of the Code. The FCAI saw this amendment to the Code as a catch-all gesture undertaken at the behest of dealer groups. It has been the long-held FCAI position that agency sales model in relation to new motor vehicle sales was already covered by the Code and the automotive specific provisions.

9. REVIEW QUESTIONS - BEFORE ENTERING INTO A FRANCHISING AGREEMENT

Question 9 - How effective are the requirements of the Franchising Code that ensure franchisors make information available to franchisees prior to entry into a franchise agreement? If possible, please comment on the effectiveness and content required for inclusion in each of the Franchise Disclosure Register, Information Statement, Key Facts Sheet and Disclosure Document.

The FCAI membership consultation process has highlighted that OEMs see little value to the prospective and/or continuing auto dealers arising from the Franchise Disclosure Register, Information Statement, Key Facts Sheet, and Disclosure Document.

In the context of automotive franchising agreements these requirements are bureaucratically burdensome without demonstrated benefit to the prospective dealer. The review should consider a mutual opt-in opt-out mechanism for sophisticated businesses and/or consider revisiting the option of a short-form and long-form options that reflect the sophistication and resources of both parties to the franchise agreement and their ability to access legal advice.

The FCAI recommends that the review considers the operational effectiveness of the Code by considering the necessity of the complexity and size of disclosure documents, and the requirement for annexing all associated documents. This translates into unnecessary franchisor compliance cost and reduced utility and increased cost of advice for franchisees. In relation to specific disclosure elements in the Code the FCAI has the following comments:

- The Franchise Disclosure Register has created useful base level information for the franchise sector, but should not be expanded. It is essentially irrelevant to automotive franchisors and franchisees. The purpose of the Register should be redefined to simply providing a central register of all Australian franchise systems, which is a useful and realistic purpose.
- The Information Statement is a brochure on franchising with minimal utility, but low compliance cost. It addresses the perceived concern that prospective franchisees need to be warned about the risks of franchising at the earliest possibility. It is essentially irrelevant to automotive brands and dealers.
- The Key Facts Sheet is an attempt to address the concerns about the size and complexity of disclosure documents. It currently duplicates compliance obligations for franchisors, and in practice it is of minimal utility to prospective automotive franchisees.

- The disclosure document is extremely comprehensive, and many of the provisions are less relevant for automotive franchise systems. Relevant content is often obscured by excessively prescriptive disclosure requirements and voluminous attachments.

Currently the Code provides clause 8(3) that information in the disclosure document must be in the form and order of Annexure 1 and use the headings and numbering of Annexure 1. There are more than 250 separate numbers, and no context or relevance is provided for the questions. As a consequence, completed disclosure documents are long, complex, difficult to read and confusing.

Question 10 - How have changes to unfair contract terms laws impacted franchise agreements? Is the approach in the Franchising Code to regulating certain types of contract terms still appropriate?

Motor vehicle franchisees understand the risk of the contracts that they enter and are well placed to manage and understand any risks. Motor vehicle dealerships are in the main sophisticated investors with access to a host of professional advice in their day to day operations. Many franchisees are in fact large businesses with two of the largest being publicly listed companies with turnover of in excess of many billions. It should be noted that this exceeds the total revenue of a number of franchisors.

Given the size and sophistication of new car dealers the FCAI does not believe that they require further levels of protection in the Code above and beyond the economy wide regulations.

These include the unconscionable conduct provisions in the Australian Consumer Law, unconscionable conduct at common law, the obligation to act in good faith which is contained in the Code and the duty to act in good faith which is increasingly being implied into contracts and business relationships in general.

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.

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.

- 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;
- 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.

The FCAI has previously recommended that a 'small business' should be one which has an annual turnover of less than \$10m consistent with the Australian Taxation Office, which uses an aggregated turnover of less than \$10m to categorise a small business for various tax concessions.

Question 11 - Do you have any other comments on how the Franchising Code regulates the relationship between franchisors and franchisees at the point of entry into a franchise agreement?

At a structural level the Code works well, as it obliges franchisors to take a considered approach to franchising, and ensures prospective franchisees receive relevant information and have time to make a considered decision and obtain advice. With fine tuning, it can be made more efficient and costs can be reduced. In a market economy the franchise agreement must always remain the legal backbone of the relationship between two business partners. The Code and the Australian Consumer Law provide comprehensive support to the contractual framework.

Question 12 - What impact have the 2021 changes relating to compensation and return on investment had on franchisors and franchisees entering into new vehicle dealership agreements? Where possible, please provide detail on the costs and benefits the new car dealership sector has experienced because of these changes.

The FCAI has seen no evidence of any impact of these provisions other than to create legal uncertainty and unnecessary compliance cost. Part 3 of our submission provides further background and proposed amendments to the operation of the Code.

The emotional circumstances associated with the exit of GMH from the Australian market was the primary driver for the changes to part 5 of the Code relating to compensation in the event of an agreement being terminated before it expires because the franchisor withdraws from the Australian market, rationalises its networks in Australia, or changes its distribution models in Australia (clause 46A). It should be noted that the FCAI understands that GMH provided extensive and wide-ranging compensation to its dealer network even though the Code did not contain these amendments. It is also understood that that compensation package would have met the requirements of clause 46A if it had existed at the time.

The FCAI is not aware of any instances since the inclusion of clause 46A in the Code in which circumstances have occurred that would result in this clause being tested. As such it is too early for the FCAI to draw any conclusions on the costs and benefits of that specific element of the Code.

It does however remain the FCAI's position that these amendments were undertaken for political reasons and not due to systemic market failure that would justify such an intervention.

Any proposals from dealer representatives to seek to expand the scope of clause 46A to include non-renewal should be closely examined in relation to the impact on consumers and the motivation of dealers to in effect obtain rigid anti-competitive US-style dealer protections. Such further unjustified regulatory intervention would stifle innovation and the ability of both OEMs and dealers to meet changing consumer expectations around the purchasing of motor vehicles, primarily because it would lock them into a "particular way of doing business".

Furthermore, in relation to clause 46B of the Code that deals with the reasonable opportunity to obtain to make a return, during the term of the agreement, on any investment required by the

franchisor as part of entering into, or under, the agreement, the FCAI would make the following comments.

FCAI's view is that this amendment was made as a means to politically address claims made by dealer groups that there needed to be increased protections of large, sophisticated dealer groups.

There may be circumstances where a short term, such as one or two years, suits both the dealer and the OEM. For example, a new OEM entrant to the Australian market might find it difficult to attract dealers for a minimum term of 5 years where their brand is untested in the Australian market. It may be more attractive to both dealers and OEMs for each to commit to a shorter period to test the waters, so to speak.

This applies equally to new applicants for dealerships, with the likelihood of an OEM providing an untried dealer with a 5-year agreement being remote. Mandating a minimum term would remove the ability of the parties to decide for themselves what period of tenure is suitable for them in their individual circumstances.

FCAI is not aware of any evidence that the length of dealer agreement terms currently offered or granted by OEMs are manifestly insufficient to protect the legitimate interests of dealers, nor that they result in any adverse outcomes for dealers. It is important to remember that prior to agreeing to any agreement, either new or extension, the prospective franchisee has the opportunity to consider legal, financial and commercial issues as relevant.

10. REVIEW QUESTIONS - ENDURING OBLIGATIONS IN FRANCHISING RELATIONSHIPS

Question 13 - How well does the Franchising Code support franchisors and franchisees during the term of the franchise agreement? In particular, does the Franchising Code provide adequate minimum standards relating to structural and/or operational change management?

The need for structural and operational changes comes from changes in the marketplace, notably changes in consumer preferences, market competition (including the entry of new competitors) and technology. The Code should not inhibit the ability of franchisors and franchisees to respond to changes in the market.

Contract law already provides a framework for structural and operational change management. The Code supports that framework, notably by requiring detailed disclosure of information, requiring the parties to act in good faith and providing highly effective dispute resolution mechanisms. The Australian Consumer Law prohibitions on misleading or deceptive conduct, unconscionable conduct and unfair contract terms provide additional protection. Together they provide an extremely comprehensive support framework for contract law.

The recent decision in the Mercedes Case demonstrates that there is no need for any additional regulation. It reinforces and affirms a long line of legal precedent dealing with issues to some degree anticipated by the Code.

The Federal Court of Australia in *AHG WA (2015) Pty Ltd v Mercedes Benz Australia/Pacific Pty Ltd* [2023] FCA 1022 (the Mercedes Case) reinforced and clarified the law as it applies to automotive franchise agreements. The Court considered the application of the Code, and the Australian Consumer Law prohibitions on unconscionable conduct and misleading or deceptive conduct, to circumstances contemplated by some of the automotive provisions of the Code.

Specifically, the Court considered:

- end of term arrangements, and the entitlements of a franchisee to compensation;
- the decision of Mercedes Benz Australia to alter its distribution arrangements in Australia;
- the calculation of goodwill in the context of a franchise agreement; and
- what conduct might constitute breach of good faith or unconscionable conduct in the context of end of term dealings.

The FCAI considers that the Code already comprehensively addresses the requirements of the parties. The FCAI opposes any further changes to the Code which would blur or complicate the compliance requirements of franchisors, or which would seek to secure outcomes more commercially favourable than would otherwise apply at law.

The Mercedes Case is consistent with, and indeed endorsed and followed, a long line of legal precedent in relation to the issues noted above. The Court also rejected arguments that sought to alter the established law.

The FCAI rejects any submissions that seek to advance the commercial interests of one party to the franchise relationship at the expense of any other party – for example, to advance the interests of dealers at the expense of OEMs and consumers.

Question 14 - How effective are the 2021 reforms which restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure?

The FCAI accepts that there should be some base level protection but considers the current Code provisions require amendment to provide greater clarity and better reflect the variety of circumstances that occur in practice. Part 3 of this submission provides further background and suggested amendments in relation to this question.

Question 15 - What impact have the 2021 amendments to the obligation to act in good faith in relation to new car dealerships had? Where possible, please provide detail on the costs and benefits the new car dealership sector has experienced because of these changes.

The FCAI notes that the Mercedes Case provides considerable additional clarity in relation to the application of the good faith principle to motor vehicle agreements. The FCAI does not support any further legislative change in this area, as the law is clear and any ambiguity has been clarified by the Mercedes Case decision. The Code should not contradict or differ from clearly established legal principles.

11. REVIEW QUESTIONS - ENDING A FRANCHISE AGREEMENT

Question 16 - How effective are 2021 reforms to the Franchising Code which created a process for franchisees to formally request early exit from their franchise agreements?

The FCAI is not aware of any situation where this process has been used in the franchise sector. This is probably because the interdependent nature of the franchise relationship is such that conversations would take place at an earlier stage. Similarly, franchisees have a right to assign their franchise agreement and exit the franchise (with the consent of the franchisor not to be unreasonably withheld).

The FCAI believes that the current framework imposes a rigid process on the parties (in circumstances where the franchisee or the franchisor want to exit the agreement earlier) which may not be in the best interests of those parties or their customers.

New vehicle dealership agreements

Question 17 - Where possible, please comment on the impact, or expected impact, of reforms to the Franchising Code which seek to ensure franchisees are paid compensation if the franchisor terminates a new vehicle dealership agreement early. Where possible, please provide detail on the costs and benefits (or expected costs and benefits) to the new car dealership sector resulting from these changes.

FCAI is not aware of any applicable franchisors terminating any franchise prior to expiry due to withdrawing from the Australian market, rationalising their networks in Australia or changing their distribution models in Australia since the reforms were legislated. In part 3 of this submission the FCAI has provided recommendations to provide necessary clarity or certainty, address unintended consequences or reflect market reality.

Furthermore FCAI together with the MTAA and the AADA have agreed to a memorandum of understanding that, among other things, provides that the three bodies will adopt the binding arbitration dispute resolution process in the Code in relation to compensation disputes under clause 46A.

A number of major OEMs and their dealers have agreed to implement the clauses in their agreements.

12. REVIEW QUESTIONS - ENFORCEMENT AND DISPUTE RESOLUTION

ACCC and enforcement

Question 18 - Is the current role of the ACCC in relation to enforcement of the Franchising Code appropriate?

The role of the ACCC in relation to enforcement of the Code is appropriate.

Question 19 - How useful and effective are the educational resources provided by regulators (such as from the Australian Competition and Consumer Commission)? Do they ensure prospective entrants to the franchising sector are sufficiently aware of their rights and responsibilities? Is the level of industry engagement appropriate?

The FCAI welcomes the ongoing activities of the ACCC in providing educational resources that reflect the law.

Question 20 - What has been the impact of 2022 reforms which increased certain penalties available under the Franchising Code? Particular comment is sought on penalties which were increased to the greater of \$10 million, three times the benefit obtained, or 10 per cent of annual turnover?

In line with its previous submission, the FCAI would reiterate the following in relation to the increase of certain penalties available under the Code.

The impact of the 2022 reforms which increased certain penalties available under the Code to the greater of \$10m, three times the benefit obtained, or 10 per cent of annual turnover is not justified. Motor vehicles are high value items and consequently many FCAI members have high turnovers – many in excess of \$1bn – with high expenses. With an annual turnover of \$1bn, the maximum penalty facing a company would be \$300m. At the time of this change no plausible justification was provided.

The FCAI was and continues to be of the view that there is no basis for the increased penalties for breaches of the Code.

The legislation passed by the Parliament included a maximum fine of 600 penalty units for most breaches of the Code (currently \$187,000).

The prospect of a \$10m fine (or more) is particularly concerning in the context of automotive specific instances, most notably clause 46B which provides that:

A franchisor must not enter into a franchise agreement unless there is a reasonable opportunity for the franchisee to make a return on the investment required by the franchisor during the term.

The FCAI strongly disagrees with the proposition that there should be any penalty for a breach of this clause – let alone a penalty of \$10m. The breach affects one person or entity – the dealer – and the impact on that person can easily be quantified in dollars. Therefore, the more appropriate

‘punishment’ is for the franchisor to be required to pay the dealer the amount of the loss demonstrably suffered. A fine (or penalty) is only appropriate when there is a requirement for a deterrent and the impact of the breach is on the community (e.g., cartel conduct).

There might be a view that establishing a breach of clause 46B for the purposes of a penalty will be easier than in a damages case by the dealer. That will not be so. In both cases, virtually the same evidence will need to be called.

While appropriate penalties are acceptable, the fact is that within the automotive sector there is a real potential to develop a two class system – a very punitive system for those distributors that operate under the Code, and a consumer driven direct to customer model that is outside the reach of the Code. In designing any penalties for this sector the degree of difference becomes a real factor to consider – what level of penalty will achieve the desired behaviour as opposed to incentivise an exodus from the franchising model?

Dispute resolution

Question 21 - Is the role and activity of the ASBFEO in relation to supporting dispute resolution under the Franchising Code appropriate?

The FCAI works closely and collaboratively with the ASBFEO. The current ombudsman has helped to facilitate the dialogue between the FCAI, the AADA and the MTAA (the Associations) in relation to the implementation of the 2021 memorandum of understanding (MOU) to promote the establishment of a pathway for dealer representative bodies and OEMs to discuss and seek to settle disputes under the Code.

This has included the Associations encouraging their members to include a suitable clause to enter into binding arbitration under Subdivision C of the Code to resolve any issue in a dispute relating to clause 46A the Code that cannot otherwise be resolved directly or through other ADR processes under the Code, or as otherwise agreed between the parties.

ASBFEO in consultation with the Associations developed an agreed panel of a suitable arbitrators drawn from eminent lawyers, KCs, or retired judges to be used in the event of binding arbitration being used under the Code as encouraged through the MOU.

It should be noted however that many disputes are resolved either by discussion or via mediation, through agreement of the parties.

Question 22 - Do the dispute resolution provisions in the Code provide an effective framework for the resolution of disputes? In particular, are you aware of whether 2021 reforms relating to multi-party dispute resolution and voluntary arbitration have been utilised by participants in the franchising sector? If not, why not?

The dispute resolution mechanisms in the Code provide an effective framework for the resolution of disputes associated with the agreements between automotive OEMs and their dealers. Responses from FCAI members have highlighted that discussions between the parties or mediation have been successful. Arbitration is rarely used and, in most cases, mediation is preferred. If mediation does not produce a result, the court system is accessible, and rules and quality of outcomes are predictable.

13. CONCLUSION

The FCAI welcomes the opportunity to provide input into the Review of the Franchising Code of Conduct Consultation Paper.

The FCAI encourages the Review and the Federal Government to ensure that the franchising regulatory environment is one that fosters competition and innovation ensuring that consumers are able to reap the benefits of a dynamic auto retail environment – one that has low barriers to entry and some of the highest number of brands in the world and as such one that provides the largest range of vehicles at the best possible price.

The FCAI has no doubt that there will be a range of stakeholders that call for US-style regulation that entrenches the traditional dealer model at the expense of the consumer. These calls should be carefully examined for what they ultimately are – a call for further protection through increased regulatory barriers at the expense of all others - including Australian consumers.

Ultimately the FCAI believes that there is a lack of evidence to support significant market intervention in the new car market through the Code or to expand the new car dealership specific elements of the Code to other sectors beyond the standard, yet substantial, provisions of the Code.

There is however significant scope to improve the operation of the Code through a series of proposed amendments that are outlined in Part 3 of this submission.

14. PART 3 - SUGGESTED AMENDMENTS TO FRANCHISING CODE AUTOMOTIVE PROVISIONS

Part 5 of the Code was introduced very quickly, with minimal industry consultation, and has received no substantive parliamentary scrutiny or debate. It was also introduced before the increased penalties were applied to the provision by subsequent amendment to the Competition and Consumer Act.

The FCAI wishes to ensure that the current provisions correctly reflect the intention of Parliament, as they appear to create new compensation entitlements where none may previously have existed, and run counter to recent judicial pronouncements. Amendments also need to be made to remove ambiguity, enable compliance and facilitate arrangements that franchisors and franchisees would wish to operate outside the scope of the provisions. This is particularly the case given the very onerous penalties that apply to any breach of the provision.

Accordingly, this part of the FCAI submission addresses the existing provisions of the Code, and provides suggested amendments that provide necessary clarity or certainty, address unintended consequences or reflect market reality.

Part 1 – Existing Code Provisions

Compensation for early termination

Clause 46A(1) is set out below, with problematic words in yellow highlight.

46A Franchise agreement must provide for compensation for early termination

- (1) A franchisor must not enter into a franchise agreement unless the agreement:
 - (a) provides for the franchisee to be compensated if the franchise agreement is terminated before it expires because the franchisor:
 - (i) withdraws from the Australian market; or
 - (ii) rationalises its networks in Australia; or
 - (iii) changes its distribution models in Australia; and
 - (b) specifies how the compensation is to be determined, with specific reference to the following:
 - (i) lost profit from direct and indirect revenue;
 - (ii) unamortised capital expenditure requested by the franchisor;
 - (iii) loss of opportunity in selling established goodwill;
 - (iv) costs of winding up the franchised business.

Clause 46A was introduced to address dealer concerns in relation to the Holden market exit from new car sales. The Holden dealer agreement was a fixed term agreement, with a set expiry date.

Clause 46A seems to assume all dealer agreements are fixed term, and appears to give no consideration to the many “legacy” agreements (or agreements without a fixed end date)¹³. In that context the words “terminates before it expires” could mean that the clause applies to every type of legacy agreement. (The other interpretation is nonsensical, as it would mean that the clause would never apply to a legacy agreement.) This issue alone demonstrates the problems with the provision.

Furthermore, although clause 46A addresses the dealer concerns with potential implications of Holden’s withdrawal from the Australian market, not only did most of those concerns not materialise¹⁴, but clause 46A actually goes much further. Sub-clauses (1)(a)(ii) and (iii) create mandatory entitlements if a franchisor “rationalises its networks” or “changes its distribution models” in Australia. Neither of these broad terms is defined in the Code.

Franchisors seeking to ensure their dealer agreements comply with the provisions, and noting the potential \$10 million fine that applies to any breach of the provisions, face unreasonable uncertainty. While withdrawal from the Australian market can be clearly established, it is impossible to determine what action would constitute network rationalisation or changes to distribution models. For example:

1. Can a franchisor with an evergreen agreement ever make any change to its network or its method of distribution? Arguably not, as termination would occur “before the agreement expires”, as there is no expiry date.
2. Would closure of a single outlet constitute “rationalisation”?
3. Would the introduction of an entirely different brand or vehicle range constitute a change in distribution models?
4. Does the clause cover the situation where termination occurs as a result of breach by the dealer, but in circumstances where the franchisor has also decided to alter distribution arrangements?

Not only is it legally unclear when clause 46A(1)(a) actually applies, but there are multiple possible interpretations of clause 46A(1)(b):

1. It is sufficient to only make general reference to compensation arrangements; and/or
2. It is not necessary to offer compensation in every category provided there is disclosure as to where compensation will and will not be offered; and/or
3. It is possible to offer zero compensation for some of the categories under subclause (b); and/or

¹³ A typical legacy agreement will have no fixed term, but give one or more parties the opportunity to terminate the agreement by a period of notice. Clause 28(3) of the Code then applies to require the franchisor to give “reasonable written notice of the proposed termination, and reasons for it.”

¹⁴ It should be noted that the clause in fact does not correctly reflect the Holden circumstances, as the Holden dealer agreements were not terminated unilaterally by Holden. For the vast majority of Holden dealers, termination occurred by agreement between Holden and the dealer, with such agreements also providing for payment of agreed compensation for the cessation of new Holden vehicle sales.

4. It is necessary to provide compensation in each category, and to precisely specify how compensation is to be determined, such that a prospective franchisee can calculate their compensation entitlements from reading the agreement.

Furthermore, the sub-clauses under clause 46A(1)(b) are vague and uncertain, and in some cases conflict with entitlements that would apply at law in the context of damages. This is unlikely to have been the intention of Parliament when the regulations were introduced. The FCAI considers that the sub-clauses under clause 46A(1)(b) should reflect and be consistent with entitlements at law.

To emphasise the ambiguity and uncertainty when trying to specify in the dealer agreement how compensation is to be determined, and again noting the potential \$10m pecuniary penalty for any breach:

- Any loss of profits should be measured by the actual impact of the decision on the profit of the franchisee, not by reference to direct or indirect revenue.
- At the time of drafting the agreement, how can a franchisor determine what capital expenditure has been requested, and what amortisation should be applied? (Noting also that the usual reference is in relation to “required” expenditure, not “requested” expenditure. See for example the wording of clause 46B, discussed below.)
- The concept of lost opportunity from selling established goodwill is not known to the law, and runs contrary to clearly understood principles for calculating damages.
- Why should a franchisor have to pay for the costs of winding up a franchisee’s business should the franchisee elect to wind up its business? How does this apply in the context of a multi-brand dealership?

The FCAI submits that clause 46A of the Code should be replaced by the following provision, which retains the legislative intent but addresses the regulatory uncertainty and maintains consistency with established legal principles in terms of the calculation of damages. The Mercedes Case clearly sets out how damages should be correctly defined and calculated, referencing a long line of legal authority. The Code provisions should be consistent with well-established legal principles.

46A Franchisee entitled to compensation for early termination

- (1) A franchisee is entitled to be compensated by the franchisor if the franchise agreement is terminated before it expires otherwise than in accordance with clause 26B, 27, 28 or 29 of the Code.
- (2) The compensation shall be the amount of damages that would apply at law in the circumstances where the franchisor had unlawfully terminated the franchise agreement.

Stock buyback arrangements

The Code sensibly codified what was broad industry practice, but did so in a way that has created anomalies and unintended consequences. The points made above in relation to clause 46A(1)

apply equally to clause 46A(2). In addition there is a need to more fully consider all potential circumstances, so as to avoid creating unintended consequences or opportunities for abuse. The suggested changes to clause 46A(2) below address the following factual circumstances not properly contemplated by the current provision:

- The franchisee gives notice of proposed termination under clause 26B of the Code;
- Spare parts and service arrangements are either subject to separate agreement, or are to continue;
- The franchisee seeks to act opportunistically in the context of the broad and uncertain terms relating to network rationalisation or changed distribution models.

The FCAI considers that it is reasonable for there to be some link between any alleged rationalisation or change in distribution and the particular franchisee, and for the franchisee to be required to activate the right given by clause 26B of the Code. The following suggested changes are suggested to clause 46.

- (2) A franchisor must not enter into a franchise agreement unless the agreement contains provision for the franchisor to buy back or compensate the franchisee for new road vehicles, spare parts and special tools if:
 - (a) the franchise agreement is not renewed and a new agreement is not entered into; or
 - (b) the franchise agreement is terminated before it expires because the franchisor:
 - (i) withdraws from the Australian market; or
 - (ii) rationalises its networks in Australia, in a manner that materially impacts the viability of the franchisee's business and the franchisee serves on the franchisor a proposal for termination of the franchise agreement pursuant to clause 26B of the Code. ; or
 - (iii) changes its distribution models in Australia in a manner that materially impacts the viability of the franchisee's business and the franchisee serves on the franchisor a proposal for termination of the franchise agreement pursuant to clause 26B of the Code.

Civil penalty:

- (a) for a contravention by a body corporate—the amount under clause 5A; or
- (b) for a contravention by a person who is not a body corporate—\$500,000.

- (3) A franchisor must not enter into a franchise agreement that contains a provision that purports to exclude any compensation to which the franchisee may be entitled, other than under the agreement, if the agreement is terminated before it expires other than because the franchisee has breached the agreement.

Civil penalty:

- (a) for a contravention by a body corporate—the amount under clause 5A; or
- (b) for a contravention by a person who is not a body corporate—\$500,000.

Franchisee return on investment

The principle underpinning clause 46B is accepted, being that a franchisor should consider the likely return on investment for any required capital investment. However in addressing legitimate concerns the provision fails to deal with many circumstances where strict operation of the provision would not be in the interests of either franchisors or franchisees. Fair regard must also be taken of the extremely onerous penalties for breach of the provision.

The FCAI suggests the following changes to clause 46B to address these unintended consequences, and permit alternative arrangements in certain circumstances.

Sub-clause (a) addresses the increasing number of circumstances where the franchisee is a multi-brand franchisee, and capital investment relates to the franchisee's broader business. Apart from being large businesses in their own right, multi-brand franchisees are usually very able to convert capital investment to other purposes at the end of any fixed term should no extension be desired or granted.

Sub-clauses (b) and (c) are self-explanatory.

Sub-clause (d) addresses the situation where the franchisee understands the risk, but chooses to take it. This is quite common. Without this provision franchisors will be forced to refuse to renew or extend agreements in marginal circumstances, and notwithstanding the desire of franchisees to continue. Rural and regional franchisees could be particularly affected. Franchisees should be entitled to accept risk in these circumstances.

46B Franchise agreement must provide reasonable opportunity for return on franchisee's investment

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, on any capital investment required by the franchisor as part of entering into, or under, the agreement. This provision does not apply to:

- (a) a franchise agreement relating to premises occupied by the franchisee where the franchisee or an associate is also a franchisee of another franchisor;
- (b) capital expenditure required by a landlord or third party;
- (c) capital investment required to ensure the franchisee complies with any laws, regulations or workplace requirements;
- (d) a franchise agreement where the franchisee signs a written acknowledgement that the franchisee accepts the risk that the term of the agreement may not provide a reasonable opportunity to make a return on the capital investment.

Note: If expenditure is disclosed in a disclosure document for a franchise agreement, the circumstances in which the expenditure is likely to be recouped must be discussed (see clause 30A).

Civil penalty:

- (a) for a contravention by a body corporate—the amount under clause 5A; or
- (b) for a contravention by a person who is not a body corporate—\$500,000.

End of term obligations

The provisions concerning end of term notification should be amended to reflect market place reality. Clause 48 was inserted to provide equality with clause 47, but is rarely observed in practice. The suggested amendments below better reflect what actually occurs, and reflect what franchisors really require – clear indication from the franchisee as to the franchisee’s intentions. In the circumstances it is also considered reasonable for there to be the same pecuniary penalty for clause 48 as clause 47.

47 Notification obligation—franchisor

- (1) The franchisor of a franchise agreement must notify the franchisee, in writing, whether the franchisor intends, at the end of the term of the franchise agreement, to:
 - (a) extend the agreement; or
 - (b) enter into a new agreement; or
 - (c) neither extend the agreement nor enter into a new agreement.

- (2) If the term of the agreement is 12 months or longer, the franchisor’s notice must be given:
 - (a) at least 12 months before the end of the term of the agreement; or
 - (b) if the parties to the agreement agree on a later time—before that later time.

Civil penalty: 600 penalty units.

- (3) If the term of the agreement is less than 12 months, the franchisor’s notice must be given:
 - (a) if the term of the agreement is 6 months or longer—at least 6 months before the end of the term of the agreement; and
 - (b) if the term of the agreement is less than 6 months—at least 1 month before the end of the term of the agreement.

Civil penalty: 600 penalty units.

- (4) If the franchisor intends to enter into a new agreement, the franchisor’s notice must include a statement to the effect that, subject to subclause 16(2), the franchisee may request a disclosure document under clause 16.

Civil penalty: 600 penalty units.

- (5) If the franchisor gives a notice that the franchisor intends to neither extend the agreement nor enter into a new agreement, the notice must include the reasons for the franchisor’s intention.

Civil penalty: 600 penalty units.

48 Notification obligation—franchisee

- (1) If required by the franchisor in writing, the franchisee of a franchise agreement must notify the franchisor, in writing, whether the franchisee intends at the end of the term of a franchise agreement, to:

- (a) renew the agreement; or
 - (b) enter into a new agreement; or
 - (c) neither renew the agreement nor enter into a new agreement.
- (2) The franchisee's notice must be given:
- (a) within 30 days of receipt of written notice from the franchisor under clause 48(1); or
 - (b) if the parties to the agreement agree on a later time—before that later time.
- Civil penalty: 600 penalty units.

Wind down arrangements

The suggested amendments to clause 49 better reflect market place reality, and do not prejudice the intent of the provision. Sub-clause (4) enables the parties to establish consistent arrangements between clause 46A(2) and clause 49. The FCAI expects most parties will choose to comply with clause 46A(2), thereby avoiding the unnecessary cost and arguable duplication of clause 49. If not, the revisions to sub-clause (2) deal with the reality that the parties in these circumstances may struggle to reach any form of agreement.

Another option would be to delete clause 49 entirely, and rely on the clear mutual interests of both parties to manage any wind down.

49 Obligation to manage winding down of agreement

- (1) This clause applies if:
 - (a) under clause 47, the franchisor gives the franchisee a notice that the franchisor intends to neither extend the agreement nor enter into a new agreement; or
 - (b) under clause 48, the franchisee gives the franchisor a notice that the franchisee intends to neither renew the agreement nor enter into a new agreement.
- (2) The parties must, as soon as practicable, agree to a written plan (with milestones) for managing the winding down of the dealership, including how the franchisee's stock (including new road vehicles, spare parts and service and repair equipment) will be managed over the remaining term of the agreement. If the parties are unable to agree within 30 days the franchisor, acting reasonably and providing justification for its decision, shall be entitled to specify a wind down plan that will apply to the dealership.
- (3) The parties must cooperate to reduce the franchisee's stock of new road vehicles and spare parts over the remaining term of the agreement.
- (4) This clause 49 shall not apply in circumstances where the franchisor agrees under the franchise agreement, or at the time, to purchase the franchisee's stock of new road vehicles, spare parts and special tools at the end of the agreement as contemplated by clause 46A(2).

Division 4—Resolving disputes

52 Franchisees may request multi-franchisee dispute resolution

- (1) This clause applies if:
 - (a) a franchisor has entered into franchise agreements with 2 or more franchisees;
and
 - (b) 2 or more of the franchisees each have a dispute of the same nature with the franchisor.
- (2) Two or more of the franchisees mentioned in paragraph (1)(b) may ask the franchisor to deal with the franchisees together about the dispute.

Note: See also Part 4 (resolving disputes).

Division 3—Capital expenditure

50 Significant capital expenditure not to be required

- (1) A franchisor must not require a franchisee to undertake significant capital expenditure in relation to a franchised business during the term of the franchise agreement.
- (2) For the purposes of subclause (1), *significant capital expenditure* excludes the following:
 - (a) expenditure that is disclosed to the franchisee in the disclosure document that is given to the franchisee before:
 - (i) entering into or renewing the agreement; or
 - (ii) extending the term or scope of the agreement;
 - (b) if expenditure is to be incurred by all or a majority of franchisees—expenditure approved by a majority of those franchisees;
 - (c) expenditure incurred by the franchisee to comply with legislative obligations;
 - (d) expenditure agreed in writing by the franchisee.

Note: Clause 30 (capital expenditure) does not apply to new vehicle dealership arrangements (see subclause 30(3)).

Capital expenditure discussion

The revisions to clause 51 set out below better reflect market place reality, without impinging on the protection provided. In many cases the franchisees have far superior knowledge and experience in their particular market. The revisions also take into consideration the circumstances of multi-brand franchisees where capital expenditure may have several purposes. Sub-clause (5) is included to respect the many possible scenarios, and in the context of potential penalties for non-compliance. Another alternative would be to delete sub-clauses (3) and (4) entirely.

51 Information and discussion about capital expenditure

- (1) This clause applies if a disclosure document for an agreement discloses expenditure of the kind mentioned in paragraph 50(2)(a).

- (2) The franchisor must include in the disclosure document as much information as practicable about the expenditure, including the following:
- (a) the rationale for the expenditure;
 - (b) the amount, timing and nature of the expenditure;
 - (c) the anticipated outcomes and benefits of the expenditure;
 - (d) the expected risks associated with the expenditure.

Example: The information could include the type of any upgrades to facilities or premises, any planned changes to the corporate identity of the franchisor's brand and indicative costs for any building materials. The franchisor shall be entitled to have regard to the knowledge and experience of the franchisee, and shall not be obliged to make disclosure where it is reasonable to expect that the franchisee will already have adequate or superior existing knowledge or experience, or will be well placed to obtain any information.

- (3) Where the franchisee has minimal knowledge or experience relative to the franchisor, before entering into, renewing or extending the term or scope of the agreement, the franchisor and the franchisee or prospective franchisee must discuss the expenditure.
- (4) Where the franchisee has minimal knowledge or experience relative to the franchisor, the discussion must include a discussion of the circumstances under which the franchisee or prospective franchisee considers that the franchisee or prospective franchisee is likely to recoup the expenditure, having regard to the geographical area of operations of the franchisee or prospective franchisee.
- (5) A document signed by the franchisor and the franchisee that they have complied with the requirements of this Division shall be sufficient to establish compliance by the franchisor with this Division.