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Franchising Code Review Secretariat Unit

Small and Family Business Division

The Treasury

Langton Cres

PARKES ACT 2600

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## **Submission to the 2023 Review of the Franchising Code of Conduct**

### **1. Introduction**

1.1 This submission is made on behalf of the Kia Dealer Council (KDC).

1.2 KDC thanks the Treasury for the opportunity to provide a submission regarding the 2023 review of the Franchising Code of Conduct (the Code).

1.3 KDC represents the interests of all Kia dealers in Australia.

1.4 KDC believes that previous reviews of the Code, specifically the 2020 and 2021 reviews and amendments are necessary to better protect automotive dealers in Australia and it is dealers that should continue to benefit from safeguards put in place by the Code.

1.5 KDC notes that the review will centre on the role and effectiveness of the Code, and the 2020 and 2021 reforms, which:

- provided for multi-party dispute resolution and clarified that agency models are captured by the Franchising Code.
- created new obligations relating to compensation in the event of early termination, and franchisees' capacity to make a return on investment.

- provided additional protections to apply at the end of a franchise term including notification requirements and processes for winding down.
- restricted the franchisors' capacity to require a franchisee to undertake significant capital expenditure.
- clarified the operation of the Franchising Code obligation to act in good faith in relation to new car dealerships.

1.6 This submission focuses on the practices employed by manufacturers in relation to their ongoing commercial relationships with dealers.

## **2. Executive summary**

2.1 Kia Australia Pty Ltd (Kia) has seen significant growth in Australia over the past decade. In 2022 it was the fourth largest seller of cars in Australia, selling over seventy-eight thousand vehicles.

2.2 As Kia has grown in prominence in Australia, it has also focused on investment in product and improvements across all vehicles. This has resulted in a steadily increasing market share for Kia.

2.3 The commercial relationship between Kia and KDC and Kia and its dealers generally have historically been exceptional and based on a mutual focus on the growth of both the Kia business and Kia's dealers in Australia.

2.4 This is achieved through Kia and KDC and its dealers working closely in relation to operational issues. Dealer principals interact and discuss innovations, new processes and operational efficiencies on a regular basis and are encouraged to discuss these with Kia.

2.5 Kia has had long-term stable management and leadership in Australia.

2.6 Kia has been led by Damien Meredith who has had several leadership roles and is the current CEO. This is in contrast to other distributors that often appoint Managing Directors or CEOs from overseas jurisdictions and who use Australia as a stepping stone to a more senior or lucrative job with their multinational corporation. These 'leaders' often spend less than 3 years in Australia. Big decisions are made without regard to past representations and accountability for the future.

## **3. Significant capital expenditure**

3.1 To operate a new car dealership, the scale of investment is in the range of \$6 to \$20 million, depending on the size and location of the dealership.

3.2 Like the majority of manufacturers, Kia may from time to time require its dealers to agree to significant capital expenditure in regard to refurbishing their facilities.

3.3 While Kia has been transparent and discussed the requirement for this significant expenditure, pursuant to clause 30A(3) and (4) of the Code. In summary, dealers are being advised that they will receive a term that justifies the expense.

3.3.1 The term being offered is 5 years and if Kia sales continue to do well, dealers may indeed recoup this investment.

3.3.2 Should Kia sales suffer for any reason, the 5-year term being offered may be insufficient to recoup this required investment.

3.3.3 While the current management remain, the history of these discussions and representations are part of the corporate history and we are confident we could work this out. However, there are concerns that should management change in the coming years, the dealers may be exposed and over-leveraged, with little protection from a non-renewal-notice (NRN) or early termination.

3.4 The ability to recoup the initial investment, or subsequent required capital expenditure, during the term of the franchise agreement is one of the greatest risks for franchisees.

#### **4. Unfair Contract Terms**

4.1 The Australian Government recently introduced the *Treasury Laws Amendment (More Competition, Better Prices) Act 2022* (Cth) to strengthen the unfair contract terms regime. The amendment, which comes into effect on 10 November 2023, retains the definition of unfair contract terms but contains changes.

4.2 From 10 November 2023, unfair contract terms are unlawful by the introduction of a statutory prohibition on proposing, applying, relying or purporting to apply and rely on any unfair contract terms in a standard form contract.

4.3 A term of a standard form contract will be unfair if the term:

*(a) causes a significant imbalance in the parties' rights and obligations under the contract;*

*(b) is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term; and*

*(c) causes financial or other detriment to a party if applied or relied on.*

4.4 These changes will also see the definition of small business be expanded to 'one that has fewer than 100 employees or less than \$10 million in annual turnover in the previous income year'.

4.5 The majority of metro Kia dealers have in excess of 100 staff, meaning that they will not be captured by any of the upcoming amendments and fall outside of the protections provided by these amendments when negotiating with Kia.

4.6 There is already a significant power imbalance between car dealers and distributors. Defining small businesses with a 100-employee definition is arbitrary. It fails to consider the significant differential in bargaining power between a small dealership and a large distributor.

4.7 Therefore, we consider that all franchisees should benefit from protections in the unfair contract terms legislation.

#### **5. Conclusion**

5.1 KDC believe the changes to the Code, aimed at protecting dealers from significant capital expenditure, are of benefit to all dealers. However, in many cases, and in the case of Kia, it can be undertaken by the dealers with the expectation that sales performance will continue as forecasted and in line with current performance and if this does not occur, dealers are relying on a renewal being granted. This is not guaranteed and may still see dealers outlay significant expense and not receive appropriate time to recoup this cost from the distributor.

5.2 The provisions within *Treasury Laws Amendment (More Competition, Better Prices) Act 2022* (Cth) are welcomed by dealers. These amendments are focused on protecting small businesses from unfair contract

terms and significant power imbalance and should protect all dealers from unfair and imbalanced negotiations. However, defining small businesses by an arbitrary number undermines these protections as many dealers in major capital cities fall outside of the maximum number of employees.

Regards

**Kia Dealer Council**