AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

RESPONSE TO 'PROTECTING CONSUMERS FROM UNFAIR TRADING PRACTICES' CONSULTATION REGULATION IMPACT STATEMENT

DECEMBER 2023

CONTENTS

Section 1: Foreword 03

Section 2: AADA Recommendations 05

Section 3: General Comments 07

Section 4: Key Focus Questions 10

Section 5: Option 1 - Status Quo 14

Section 6: Option 2 - Amend Statutory Unconscionable Conduct 16

Section 7: Option 3 - Introduce a General Prohibition on Unfair Trading Practices 19

Section 8: Option 4 - Introduce a General and Specific Prohibition on Unfair Trading Practices 20

Section 9: Conclusion 23

Section 10: References 24

Appendix A 25

FOREWORD

The AADA welcomes the opportunity to make a submission in response to the *'Protecting consumers from unfair trading practices'*, Consultation Regulation Impact Statement (the RIS).

The AADA is the peak automotive industry body representing Australia's franchised new car Dealers. There are more than 3,100 new vehicle dealerships in Australia employing more than 56,000 people directly and generating $68 billion in turnover and sales with a total economic contribution of over $17 billion.

Franchised new car Dealers are in relationships with international manufacturers which is characterised by a power imbalance. In jurisdictions such as the US, automotive franchising laws provide Dealers with a level of protection. Australia has taken steps in the right direction in recent years with the adoption of automotive specific franchise laws, but serious gaps remain and the ability for manufacturers to exploit Dealers has been evident in recent years.

The high bar required to demonstrate unconscionable conduct has at times benefitted manufacturers in disputes with their Dealer networks. The AADA strongly believes there is a need to prohibit unfair trading practices in combination with amending statutory unconscionable conduct to better capture exploitative behaviour.

The AADA is open to working with Treasury on the mechanics of the various option, but we are of the firm view that all business relationships should be covered by the reforms.

The AADA is encouraged by and welcomes proposed reforms to address Unfair Trading Practices (UTP) in the Australian Consumer Law (ACL). The AADA considers that these reforms will go some way towards addressing the use of harmful business practices not currently captured by existing protections in the ACL. While the AADA acknowledges that policy reform to deal with 'unfairness' presents many challenges due to the subjective nature of what is considered 'unfair', these reforms will help bring Australia's competition regulations in line with community expectations and other OECD countries.

The AADA strongly advocates that these protections be expanded to ALL businesses regardless of size, as many businesses that would not be covered by the proposed threshold in the RIS, are subject to unfair practices at the hands of very large and well-resourced companies in their supply chain relationships.

The AADA is broadly supportive of options 2 & 4 canvassed in the regulation impact statement (RIS). Regarding option 2, the extension of current prohibitions in the ACL on unconscionable conduct to include conduct that is unfair would provide increased protection to consumers and businesses against harmful conduct and provide the government and the regulators with more tools to address harmful conduct not currently captured by existing unconscionable conduct laws.

Regarding option 4, this would be the most comprehensive approach, through a combination of a general principles-based prohibition, with the addition of a specific list of prohibited practices. Both of these options have merit, and the AADA would encourage the adoption of a combination of these options.

These issues are examined in further detail below.

James Voortman
Chief Executive Officer

Section 2

AADA RECOMMENDATIONS

1. A reform option to address unfair trading practices be introduced.

2. Pursue option 4 as the most comprehensive option to address unfair trading practices.

3. Pursue option 2 as a combined approach with option 4.

4. Pursue option 3 as a workable solution to address unfair trading practices, as opposed to retaining status quo.

5. Expand the coverage of new reforms to capture all businesses.

Australia

3,176 Dealerships

Economic Contribution

56,829
Dealer Employees

$6.80 billion
Dealer Wages

$3.59 billion
Tax Contribution

$17.30 billion
Total Economic Contribution

GENERAL COMMENTS

AUSTRALIAN AUTOMOTIVE RETAILING INDUSTRY CONTEXT

The Australian automotive new car retailing industry can be broadly defined into two categories. Vehicle manufacturers or OEMs, which are largely multinational businesses that supply vehicles into the Australian market. Car Dealers, which are generally Australian privately owned or family businesses who enter franchise agreements to purchase vehicles from these manufacturers to retail to Australian consumers. This system is known as the franchising model and has underpinned the way in which Australians are able to buy new cars for more than a century.

NEED FOR EXPANSION OF COVERAGE TO ALL BUSINESSES

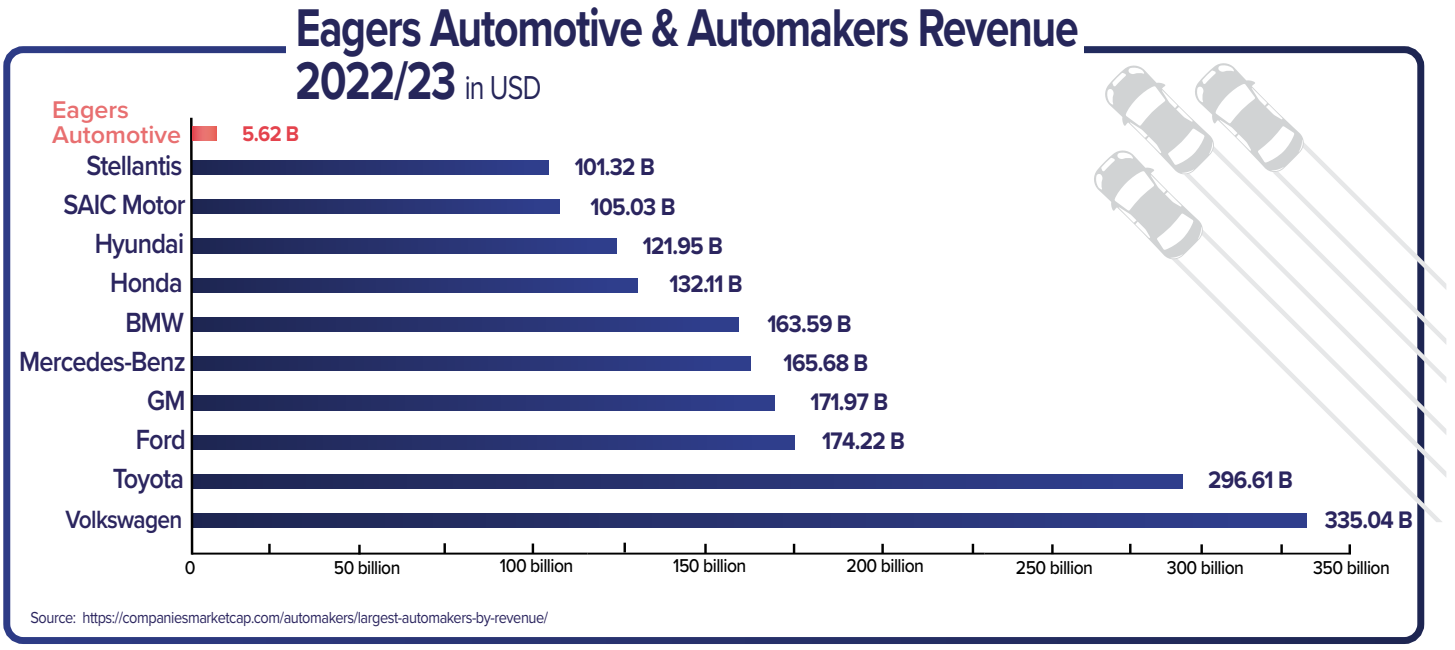
The AADA agrees with the findings in the RIS which highlight that a growing number of commercial practices fall into the category of 'unfair business practices' or 'unfair trading practices' which cause considerable harm to consumers and businesses, and thus warrant reform in this area. However, under thresholds that would define what a small business is provided on page 5, many Dealers would not qualify.

A key feature of the automotive industry in Australia that highlights the need for stronger protections against unfair trading practices is the immense power imbalance between Dealers and manufacturers whom they are in franchising relationships with. This is largely due to the disparity in size and power between these global automakers and Australian Dealers.

Car companies are ranked as some of the largest and long-standing businesses operating in one of the world's most significant manufacturing industries. For example:

- Volkswagen AG is the 15th largest company in the world ranked by revenue.
- Toyota Motor Corp is the 19th largest company in the world ranked by revenue.
- Fortune Global 500 ranks 30 automotive companies in the top Global 500 companies.

By way of comparison, Eagers Automotive (APE on the ASX), is far and away the largest Dealer group in Australia, and it turned over $8.54 billion last year. (including approximately 10% of all Australian new cars sold). However, the chart below demonstrates that even at Eagers Automotives' size, it pales in comparison to the manufacturers that Dealers are in a franchise relationship with.



DEALER/MANUFACTURER DEPENDENCY

Dealers make significant investments in their businesses, often resulting in a dependency on the ongoing right to run the franchise. With this dependency, the Dealer loses their bargaining power, and the more sunk investment the Dealer commits, the more vulnerable they are. They are vulnerable because manufacturers have extensive powers to bring franchise agreements to an abrupt end using non-renewal and termination powers. Ironically, significant portions of the investments Dealers make are a result of non-negotiable requirements prescribed by the manufacturer.

Manufacturers can exploit this vulnerability and as a result, Dealers are often subject to unfair trading practices, and on occasions that Dealers have pursued a claim through the courts, they have been on the receiving end of the very high bar required to prove unconscionable conduct or failure to act in good faith.

Indeed, the ACCC found that many challenges faced by dealers are a consequence of the misuse of power by car manufacturers. To this point, the consumer watchdog alleged unfair treatment towards franchisees in critical areas, such as non-renewal of franchise agreements, capital expenditure, and dispute resolution, all which undermines not only the dealers' businesses, but also the Australian consumers' best interests.....[1]

'An Evaluation of the Franchise Model in the Australian Automotive Industry'

The AADA considers that policy options 2 & 4 presented in the RIS would go some way towards protecting Dealers from being subject to these unfair trading practices and as such, strongly recommends that these protections be extended to all businesses.

KEY FOCUS QUESTIONS

1. DO YOU AGREE OR DISAGREE WITH THE REPRESENTATION AND SCOPE OF UNFAIR TRADING PRACTICES IDENTIFIED IN THIS PAPER?

The AADA agrees with the scope of unfair trading practices identified in the consultation paper encompassing, oppressive, exploitative, or otherwise unfair business behaviour.

2. HOW DO YOU THINK UNFAIR SHOULD BE DEFINED IN THE CONTEXT OF AN UNFAIR TRADING PROHIBITION? WHAT, IF ANY, AUSTRALIAN OR OVERSEAS PRECEDENT SHOULD BE CONSIDERED WHEN DEVELOPING THE DEFINITION? ARE THERE THINGS WHICH YOU THINK SHOULD BE INCLUDED, OR EXCLUDED, FROM THE DEFINITION?

Defining 'unfair' in the context of unfair trading practices is challenging due to the subjective nature of the term. The perception of fairness varies significantly from individual to individual and is generally context driven. The AADA considers, that while there isn't a standard definition of 'unfair', there are generally accepted principles which help to determine if an action or behaviour is unfair, for example, the principles of good faith and fair dealing.[2]

In attempting to define 'unfair' a number of Australian regulatory instruments already include the concept of unfairness.

In New South Wales, the power imbalance between franchised new car Dealers and larger more powerful manufacturers resulted in the development of Part 6 of the *Motor Dealers and Repairers Act 2013*. Under Part 6, Dealers are offered protections against Unjust Conduct. Conduct of a manufacturer is **unjust conduct** for the purposes of Part 6 if it is conduct:

(a) that occurs in connection with a supply contract and is conduct that is dishonest or unfair, or

(b) that is authorised by an unfair term of a supply contract .

(2) In determining whether to make a declaration that a term of a supply contract is an unfair term or that conduct is unjust, the Tribunal may take into account such matters as it thinks fit and is to have regard to all the circumstances of the case, including the contract as a whole.

(3) Without limiting subsection (2), the Tribunal may consider the following (if relevant) -

(a) the extent to which the supply contract is expressed in reasonably plain language and is presented clearly,

(b) whether or not there was any material inequality in bargaining power between the parties to the supply contract,

(c) whether or not at or before the time the supply contract was made its provisions were the subject of negotiation,

(d) whether or not it was reasonably practicable for a motor dealer to negotiate for the alteration of or to reject the term of the supply contract or any matter related to the contract,

(e) whether a term of a supply contract imposes conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the supply contract,

(f) whether or not and when independent legal or other expert advice was obtained by the motor dealer,

(g) whether any undue influence, unfair pressure or unfair tactics were exerted on or used against the motor dealer -

(i) by any other party to the supply contract, or

(ii) by any person acting or appearing or purporting to act for or on behalf of any other party to the supply contract, or

(iii) by any person to the knowledge (at the time the supply contract was made) of any other party to the supply contract or of any person acting or appearing or purporting to act for or on behalf of any other party to the supply contract,

(h) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.

Another example to consider is Unfair Contract Terms (UCT) in the *Trade Practices Amendment (Australian Consumer Law) Act (No.1) 2010*. In which, deciding whether a term in a standard form consumer contract is unfair, the court or tribunal will apply the three-limbed test for unfairness.

A number of international jurisdictions have already sought to or have defined what is unfair in a business practice context, for example:

- The European Commission has defined Unfair Trading Practices as *practices that deviate grossly from good commercial conduct, are contrary to good faith and fair dealing and are unilaterally imposed by one trading partner on another.*[3]
- In the United States, the Federal Trade Commission Act (FTC Act) contains a general prohibition against 'unfair or deceptive acts or practices in or affecting commerce'. The FTC Act defines an act or practice to be unfair when it; causes or is likely to cause substantial injury to consumers, cannot be reasonably avoided by consumers or is not outweighed by countervailing benefits to consumers or to competition.

3. DO YOU HAVE ANY SPECIFIC INFORMATION, ANALYSIS OR DATA THAT WILL HELP MEASURE THE IMPACT OF THE PROBLEMS IDENTIFIED?

The automotive retailing industry in Australia contains many examples, where manufacturers exploit the power imbalance that characterises their franchise relationship with Dealers. The language and provisions contained in franchising agreements are often skewed to favour the manufacturer and due to the David and Goliath style match-up between these parties, Dealers are often at the receiving end of unfair practices. There are a number of areas where the practices employed by manufacturers could amount to unfair trading practices. Among these include:

- Terminating Dealer agreements and pressuring Dealers to accept inadequate compensation within very tight deadlines.
- Offering short term Dealer Agreements with no prospect of recovering investment.

- Linking major investment to the renewal of a franchise agreement.
- Pressuring dealers to take on additional stock and register vehicles as sold to improve market share of the manufacturer.
- Refusing to indemnify Dealers (a legal obligation) for work done to honour an OEM's warranty and Australian Consumer Law obligations.
- Conducting random warranty audits, clawing back large sums of money by extrapolating the results from a small sample over an extended period of time.
- Setting unrealistic sales and performance targets and using failure to achieve targets to penalise dealers financially.
- Making unilateral significant changes to the business model with little to no negotiation with Dealers.

This is also demonstrated in the numerous disputes and court actions between Dealers and manufacturers in recent years.

- General Motors (GM) termination of the Holden brand and 200 Dealers in Australia. The way in which GM treated its Dealers led to a Senate Inquiry that extraordinarily censured GM. It also prompted the ACCC to issue a rebuke of Holden calling it 'a lesson to all franchisors of what not to do in managing their relationships with franchisees and treating them fairly and with respect'.
- The recent case before the Federal Court in which Mercedes-Benz Dealers unsuccessfully sought compensation from Mercedes-Benz Australia for converting their dealerships to an agency model. (See Appendix A). It should be noted that Justice Beach made the extraordinary comment that the Dealers "were successful on many issues of fact but lost on the law." He went on to suggest that the legal framework governing franchise relations may need to be reviewed.
- The conduct by Honda as part of its move to an agency model. Specifically, the ACCC has instituted Federal Court proceedings against Honda Australia Pty Ltd for making false or misleading representations to consumers about two of the Dealers which were terminated as part of the move to an agency model, stating that these businesses were closed when in fact they were still trading.

Most examples of unfair behaviour from manufacturers are not aired publicly such as the examples above. The fear of speaking up on these issues has only escalated following the behaviour exhibited by some manufacturers in recent years. Unfair conduct has significant financial consequences for franchised new car Dealers, who are increasingly being pressured to invest or sacrifice margins to fulfill a Manufacturers demands. The result can be a stressful arrangement which effects Dealers psychologically and filters down into the staff of the business.

4. DO YOU AGREE WITH THE CONSULTATION OBJECTIVES AS OUTLINED? IF NOT, WHY NOT?

The AADA agrees with the consultation objectives outlined in the RIS.

5. ARE THERE ANY OTHER CONSULTATION OBJECTIVES THAT SHOULD BE CONSIDERED IN ADDRESSING UNFAIR TRADING PRACTICES IN AUSTRALIA?

The AADA has no comment.

6. AS A CONSUMER OR SMALL BUSINESS, HAVE YOU SUFFERED DETRIMENT FROM UNFAIR TRADING PRACTICES? PLEASE DESCRIBE YOUR EXPERIENCE AND QUANTIFY THE IMPACT IN MONETARY TERMS, IF POSSIBLE.

As noted above, there are numerous examples of unfair behaviour from manufacturers, but they are not always highlighted in the public domain. Dealers often have a natural fear of speaking up on these issues, making it difficult to quantify the impact that unfair trading practices have, as such, the AADA would encourage the opportunity to discuss these matters confidentially as part of the consultation process.

7. HAVE YOU EXPERIENCED ANY DIFFICULTIES WITH CHALLENGING OR DISPUTING A POTENTIALLY UNFAIR TRADING PRACTICE? PLEASE PROVIDE ANY RELEVANT DETAILS.

For Dealers disputing an unfair trading practice with a manufacturer, success varies according to the nature of the relationship. There are relationships within the automotive retail industry which are respectful and mutually beneficial. We have heard examples of Dealers in these relationships being able to successfully address a certain practice and negotiate with a franchisor to achieve a mutually satisfactory outcome.

However, there are many relationships where practices perceived to be unfair by Dealers are not up for negotiation. In fact, Dealers who are prepared to raise unfair behaviour with their franchisor are often labelled a troublemaker and liable to be punished or marginalised because of their willingness to speak up.

8. WHAT IS YOUR PREFERRED REFORM OPTION, OR COMBINATION OF OPTIONS? WHAT ARE YOUR REASONS?

The AADA considers that a combination of options 2 & 4 canvassed in the RIS offers the most comprehensive solution to address unfair trading practices. Our reasoning is detailed below.

9. ARE THERE ANY ALTERNATIVE OR ADDITIONAL REFORM OPTIONS TO THOSE PRESENTED YOU THINK SHOULD BE CONSIDERED?

AADA believes that the work on unfair trading practices needs to be supplemented by strengthening the automotive provisions of the Franchising Code of Conduct. We have attached a copy of our submission to the current review of the Franchising Code of Conduct.[4] (Attachment 1)

OPTION 1 - STATUS QUO

1.1 DO YOU AGREE WITH THE IMPACT ANALYSIS OF THIS OPTION? ARE THERE OTHER ISSUES THAT SHOULD BE TAKEN INTO ACCOUNT WHEN ANALYSING THE IMPACT OF THIS OPTION?

The AADA does not support option 1 - Status quo. The automotive industry is currently in a state of transformation and with that change comes a real risk that unfair trading practices will be used by manufacturers looking to make significant changes to the long-term arrangements they have had in place with their Dealers. Maintaining the status quo will likely increase the risk of harm in the medium to long term.

1.2 IF A TRADING PRACTICE IS FOUND TO HAVE CAUSED CONSUMER HARM, DO YOU THINK THAT THE COURTS ARE ABLE TO DETERMINE APPROPRIATE REMEDIES IN LINE WITH COMMUNITY EXPECTATIONS UNDER THE CURRENT LEGAL FRAMEWORK? IF NOT, WHY NOT?

The AADA considers that the current framework does not protect consumers and businesses against unfair practices. This was highlighted in the recent court action between Mercedes-Benz Australia/ Pacific Pty Ltd and the majority of its Dealers. The AADA would argue that the law has allowed Mercedes-Benz to essentially engage in unfair practices by changing the nature of a decades-long business relationship to its benefit and with no compensation to those Australian businesses.

Justice Beach stated that "... the shift to the agency model was in large part a case of franchisor opportunism because [Mercedes-Benz Australia] took advantage of its position after the dealers had made significant investments, and it intended to appropriate the gains in the industry margins associated with the move to the agency model;"[5]

From our perspective, the comments made by Justice Beach quoted above, underscore the crux of the matter. Without the introduction of any protections against unfair trading practices, businesses can continue to engage in these behaviours which are oppressive, exploitative, or otherwise unfair, but do not amount to the high bar which is unconscionable conduct.

Even when businesses are subject to unlawful behaviour, they are dissuaded from pursuing this in the courts due to the expensive, time-consuming, and emotionally draining nature of the legal system. On occasions that Dealers have pursued a claim through the courts such as the example above regarding Mercedes-Benz Dealers, they have been on the receiving end of the very high bar required to prove unconscionable conduct or failure to act in good faith, further highlighting the need for general and specific prohibitions to deter behaviour.

1.3 COULD A FOCUS ON STAKEHOLDER EDUCATION HELP REDUCE THE PREVALENCE OF UNFAIR TRADING PRACTICES UNDER EXISTING CONSUMER PROTECTIONS?

The AADA considers that stakeholder education would not provide sufficient protection to consumers and businesses against unfair conduct. Even though it may be very clear that a business or consumer is being subject to unfair practices they are often placed at a position of disadvantage with no recourse, due to the size and resources behind the offending party.

OPTION 2 - AMEND STATUTORY UNCONSCIONABLE CONDUCT

2.1 DO YOU AGREE WITH THE IMPACT ANALYSIS OF THIS OPTION? ARE THERE OTHER BENEFITS OR COSTS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN ANALYSING THE IMPACT OF THIS OPTION?

The AADA agrees with the impact assessment of option 2, which is assessed as having a medium regulatory impact - providing some benefits to consumers and businesses while acknowledging the imposition of some compliance costs. The AADA considers that option 2 has merit and as outlined in the RIS, its benefits outweigh the potential costs, which are largely comprised of compliance costs.

2.2 WHAT WOULD BE THE IMPACT OF PURSUING THIS POLICY OPTION FOR CONSUMERS AND BUSINESSES?

The AADA does see option 2 as having merit and this option could help to provide consumers and businesses with greater confidence in their business dealings that they will not be subject to unfair practices. If expanding the scope of statutory unconscionable conduct to capture a broad range of conduct considered to be harmful or unfair is pursued, clarity would need to be provided regarding how 'unfair' is defined and ensure that it is not just used as one factor in determining if actions are unconscionable. As noted above, unconscionable conduct has a very high threshold and under this option, reliance would continue to be placed on the term 'unconscionable' making it difficult to capture conduct that is considered unfair.

Option 2 must take the alternative approach outlined on page 23 of the discussion paper which is to add the concept of unfairness to the unconscionable conduct provision in s21 of the ACL. This is to ensure that courts must consider this concept of unfairness in determining unconscionable conduct by creating a clear distinction between the currently accepted meaning of unconscionable and the newly derived lower threshold.

2.3 ARE THERE ANY CONSEQUENCES OR RISKS THAT NEED TO BE CONSIDERED WHEN PURSUING THIS POLICY OPTION? PLEASE PROVIDE DETAILS.

The AADA considers that the risk associated with option 2 is the need for judicial precedent to be set on the amended definition of unconscionable conduct and could result in a situation where businesses and consumers continue to be subject to unfair practices while waiting for the courts to set precedent regarding what businesses practices amount to unfair conduct.

2.4 WOULD THIS POLICY OPTION PLACE ANY ADDITIONAL FINANCIAL OR ADMINISTRATIVE COST OR BURDEN ON SMALL BUSINESSES AND/OR CONSUMERS?

The AADA does not believe that option 2 would add any financial or administrative burden to Dealer's businesses. The AADA considers that without the addition of specific prohibitions, it will be up to the courts to decide if conduct would arise to

the newly expanded definition of unconscionable conduct thus placing the onus on the business or consumer on the receiving end of these practices to take action.

2.5 DO YOU CONSIDER AMENDING 'UNCONSCIONABLE CONDUCT' UNDER THE ACL WOULD SUFFICIENTLY DETER BUSINESSES FROM ENGAGING IN UNFAIR TRADING PRACTICES? PLEASE PROVIDE REASONS FOR YOUR RESPONSE.

Amending unconscionable conduct under the ACL would in theory provide a significant deterrent for businesses seeking to engage in practices that are unfair. If businesses were aware that the newly expanded definition of unconscionable would apply to unfair practices, they would be deterred from engaging in these practices. However, as mentioned above, this option does run the risk that 'unconscionable' would continue to be central to these provisions and may be difficult to capture manifestations of unfair behaviour.

The aforementioned case of *AHG WA (2015) Pty Ltd T/A Mercedes-Benz Perth and Westpoint Star Mercedes-Benz and Others and Mercedes-Benz Australia/ Pacific Pty Ltd*, highlights the high threshold to be met before conduct will be considered 'unconscionable'.

The AADA considers that amending unconscionable conduct in the ACL without the introduction of specific prohibitions outlining specific practices that broadly cover what is deemed an unfair practice, businesses and consumers may be reluctant to dispute these practices.

2.6 WHAT FORMS OF UNFAIR TRADING CONDUCT COULD BE INCLUDED AS ADDITIONAL FACTORS IN SECTION 22?

If this approach is taken under option2, the AADA would welcome the inclusion of practices that occur as a result of imbalances of power in a list of additional factors to be included under s22.

An example of these, taken from *'Study on the Legal Framework Covering Business-To-Business Unfair Trading Practices in the Retail Supply Chain'* prepared for the European Commission, are listed as situations where:

- weak parties have no real alternative to the commercial relation at hand;
- when one of the parties depends on its counterparts due to other factors, such as technology and know-how;
- when one of the parties can exploit informational advantages to the detriment of the other party;
- and in case of incomplete contracts, which leave room for strategic behaviour during the course of the negotiation.[3]

The AADA would encourage the examination of international examples of how unfair trading practices are defined as a way to include particular conduct as additional factors in s22.

2.7 DO YOU THINK THAT THE PROHIBITION SHOULD BE MADE PROSPECTIVE, SO IT APPLIES TO CONDUCT THAT IS LIKELY TO BE UNCONSCIONABLE? WHY OR WHY NOT?

The AADA agrees that the prohibition should be made prospective.

2.8 SHOULD THE LIST OF FACTORS CONTAINED IN SECTION 22 BE MANDATORY FOR COURTS TO CONSIDER IN DETERMINING WHETHER CONDUCT IS UNCONSCIONABLE? IN OTHER WORDS, SHOULD SECTION 22 BE AMENDED SO THAT THE COURTS MUST HAVE REGARD TO THE LIST OF FACTORS FOR THE PURPOSES OF SECTION 21?

Yes, if this option is pursued, the AADA would encourage that the list of factors contained in s22 be mandatory for consideration. This is to ensure that the true meaning of the newly expanded provisions of unconscionable conduct does capture that behaviour that may not necessarily meet the high bar for unconscionable conduct is mandatory.

2.9 ARE THERE ANY OTHER PRINCIPLES THAT WOULD BE USEFUL TO CONSIDER IN AMENDING STATUTORY UNCONSCIONABLE CONDUCT? PLEASE PROVIDE DETAILS

The AADA has no comment.

OPTION 3 - INTRODUCE A GENERAL PROHIBITION ON UNFAIR TRADING PRACTICES

3.1 DO YOU AGREE WITH THE IMPACT ANALYSIS OF THIS OPTION? ARE THERE OTHER BENEFITS OR COSTS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN ANALYSING THE IMPACT OF THIS OPTION?

The AADA prefers options 2 and 4 over option 3 - Introduce a general prohibition on unfair trading practices - but would favour this option over retaining status quo.

OPTION 4 - INTRODUCE A GENERAL AND SPECIFIC PROHIBITION ON UNFAIR TRADING PRACTICES

4.1 DO YOU AGREE WITH THE IMPACT ANALYSIS OF THIS OPTION? ARE THERE OTHER BENEFITS OR COSTS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN ANALYSING THE IMPACT OF THIS OPTION?

The AADA agrees with the impact analysis of option 4 which highlights that this option provides protection for consumers and businesses from the widest range of both current and emerging unfair trading practices.

4.2 ARE THERE ANY CONSEQUENCES OR RISKS THAT NEED TO BE CONSIDERED WHEN PURSUING THIS POLICY OPTION? PLEASE PROVIDE DETAILS.

The AADA notes that the judicial precedent on a general prohibition may take time to develop and the list of specific instances may not sufficiently cover every practice which is considered unfair and is not permitted, however, the AADA considers this to be the most comprehensive approach.

4.3 WOULD THIS POLICY OPTION PLACE ANY ADDITIONAL FINANCIAL OR ADMINISTRATIVE COST OR BURDEN ON SMALL BUSINESSES AND/OR CONSUMERS?

The AADA does agree with the conclusion in the RIS, that under this option uncertainty may arise over what constitutes an unfair practice and may create an environment where businesses are cautious. However, we believe it will encourage more cooperative attitudes from franchisors towards their franchisees which will facilitate better discussion and negotiation. AADA considers that this option will best meet community expectations around what they expect in their dealings with businesses and would align Australia with international jurisdictions that have taken this approach to addressing unfair practices.

4.4 DO YOU CONSIDER A SPECIFIC PROHIBITION ON UNFAIR TRADING PRACTICES IN THE FORM OF A LIST OR SCHEDULE OF UNFAIR CONDUCT WOULD BE AN ADAPTABLE POLICY OPTION FOR TECHNOLOGICAL CHANGE?

The AADA considers that a list or schedule of unfair practices may be difficult to continue to update at the same rate as technological advancements in the business space. One example of this is the use of blended sales models in automotive retailing, where manufacturers will require some products to be sold on a regular franchise model basis, but other products to be sold on an agency basis. While many jurisdictions have prohibited franchisors from competing with franchisees, they are often able to overcome this through the changing business models when introducing new technologies.

This is largely seen in the retailing of new vehicle technologies such as electric vehicles (EVs) which are supplied to Dealers on an agency basis while traditional ICE cars remain on the franchised system. This practice the AADA would consider to be an unfair practice as it allows a manufacturer to

essentially compete with its Dealers while in effect using the franchisee's facilities and sunk investment to do so. Manufacturers should not be allowed to employ blended models - it blurs the lines around their ability to gain exemptions from retail price maintenance provisions; it potentially allows manufacturers to saddle Dealers with risk on undesirable products while cherry-picking the best and most profitable models for their own purpose to be sold at a fixed price.

This example highlights the risks associated with a stand-alone list of specific prohibitions as large businesses have vast resources to sidestep regulation and alter their business models to avoid running afoul of prohibited practices.

4.5 DO YOU CONSIDER A SPECIFIC PROHIBITION ON UNFAIR TRADING PRACTICES WOULD SUFFICIENTLY DETER BUSINESSES FROM ENGAGING IN CONDUCT THAT IS CONSIDERED UNFAIR, HARMFUL OR DETRIMENTAL TO CONSUMERS?

As noted above, a specific prohibition on unfair practices may not sufficiently cover all aspects of what constitutes an unfair practice, and any specific prohibition would need to be introduced in conjunction with a general prohibition. The AADA notes, as described in the RIS, that no international jurisdiction has introduced or enforced a stand-alone specific unfair practices prohibition without also having a general unfair practices prohibition in place.

4.6 WHAT TYPES OF UNFAIR TRADING PRACTICES SHOULD BE SPECIFICALLY PROHIBITED? SHOULD THEY BE INDUSTRY SPECIFIC OR ECONOMY-WIDE?

The AADA would call for the inclusion of practices that arise as a result of an imbalance of power in a barging arrangement, which could include things such as a party having no real alternative to the commercial relation or exploitation of informational advantages.

However, there are several factors that make the dealer and manufacturer relationship different to the typical franchising or business relationship.

The same is true of the OEM/Truck Dealer relationship, including:

- High levels of capital expenditure required.
- Unique facilities such as bespoke showrooms and workshops which are distinctive and very difficult to repurpose.
- Manufacturers are all subsidiaries of powerful offshore multi-national companies which are among the largest in the world.
- High value product which are mechanically and technologically sophisticated relative to other goods.
- There is an extended after sales relationship between a dealer and its customers.
- Continued aftersales relationship with the manufacturer related to warranty and servicing.

These examples highlight the dependant nature of the Dealer on their manufacturer in their relationship and considers that this warrants further exploration of the need for an industry specific list of unfair trading practices prohibition.

Determining what practices should be specifically prohibited would take time to develop and would encourage further consultation on defining specific unfair practices.

4.7 SHOULD CIVIL PENALTIES BE ATTACHED TO A COMBINED PROHIBITION ON UNFAIR TRADING PRACTICES? PLEASE PROVIDE REASONS FOR YOUR RESPONSE.

The AADA considers that businesses who are found to have engaged in prohibited unfair trading practices, should be subject to monetary penalties.

Section 9

CONCLUSION

We would be happy to meet with you to discuss our submission and participate in any further consultation. If you require further information or clarification in respect of any matters raised, please do not hesitate to contact me.

James Voortman
Chief Executive Officer

REFERENCES

1 - An Evaluation of the Franchise Model in the Australian Automotive Industry Fattah, Adiba, https://research.usc.edu.au/esploro/outputs/doctoral/An-Evaluation-of-the-Franchise-Model/99971186702621/filesAndLinks?index=0

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4 - AADA Response to the Review of the Franchising Code of Conduct Consultation Paper, https://www.aada.asn.au/wp-content/uploads/2023/10/2023.09.29-Franchising-Code-of-Conduct-Review_Final.pdf

5 - AHG WA (2015) PTY LTD T/A MERCEDES-BENZ PERTH AND WESTPOINT STAR MERCEDES-BENZ and OTHERS And MERCEDES-BENZ AUSTRALIA/PACIFIC PTY LTD

ATTACHMENT A: MERCEDES-BENZ DEALER ACTION - CASE STUDY

Mercedes-Benz Australia (MBAuP) changed its business model from the traditional franchise model to an agency model. Almost 80% of MBAuP Dealers objected to the way in which the change to the business model was brought about, launching an action in the Federal Court of Australia. Among their claims was that MBAuP engaged in unconscionable conduct in the way it treated its Dealers.
All claims against MBAuP were dismissed, but in handing down his judgement Justice Jonathan Beach said, "that the applicants were successful on many issues of fact but lost on the law."

He went onto state that "the applicants' strongest case, although unsuccessful, concerned statutory unconscionable conduct".

In the publicly available judgement, Justice Beach listed off a series of behaviours MBAuP, including:

- MBAuP cherry-picked the best bits of the dealers' businesses on which the agency model was imposed and left the dealers with less desirable features.
- The dealers ultimately had a lack of choice concerning the terms of the agency agreements. Ultimately, they were presented on a take it or leave it basis they were given little time to negotiate the final form of the agency agreements and the associated agreements.
- There was no meaningful negotiation that the new model to be imposed would be an agency model.
- And on the main commission aspects, in my view MBAuP and MBAG ratcheted this down as low as they thought that they could get away with.
- I accept that the dealers were ultimately placed in a position of situational disadvantage and possibly constitutional disadvantage in terms of the agency model.
- MBAuP did not consider the individual circumstances of dealers. Moreover, it had little regard for the top 30% of dealers who were likely to suffer under the agency model. It noted that effect but had no sympathy for it.
- There were various themes that from time to time MBAuP put to dealers that were either exaggerated or turned out to be incorrect.
- It was put that the substantial reason justifying the agency model was because of the problem of disruptors, aggregators and future on-line transactions. These so-called concerns were also used in an effort to spook the dealers.
- MBAuP persistently ran the line that a concern was the intra-brand discounting between dealers and that the agency model was designed to avoid this. But the reality was that most of the intra-brand discounting was brought about by MBAuP's and MBAG's conduct in causing over-supply to increase market share and also the incentives to discount that MBAuP itself created flowing from its commission structure with the dealers.

Despite, these assertions, Justice Beach still decided that this behaviour did not amount to statutory unconscionable conduct, reinforcing the very high bar needed to prove such an offence as demonstrated by other cases in the franchising sector such as the Pizza Hut case and ACCC's undertaking with the Retail Food Group.

***Note the above material is taken from Justice Beach's judgement in AHG WA (2015) PTY LTD T/A MERCEDES-BENZ PERTH AND WESTPOINT STAR MERCEDES-BENZ and OTHERS And MERCEDES-BENZ AUSTRALIA/PACIFIC PTY LTD**

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AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

RESPONSE TO THE REVIEW OF THE FRANCHISING CODE OF CONDUCT CONSULTATION PAPER

SEPTEMBER 2023

CONTENTS

Section 1: Foreword 03

Section 2: AADA Recommendations 05

Section 3: Automotive Industry Context 07

Section 4: Insecurity of Tenure and Franchisor Use of Termination and Non-Renewal Powers 09

Section 5: Goodwill 11

Section 6: Unfair Contract Terms and Trade Practices 13

Section 7: Agency Distribution 15

Section 8: The Need to Extend Part 5 of the Code to Include Truck Dealers 16

Section 9: Separation of Agreements 18

Section 10: Disputes 20

Section 11: Franchisees As Investors 22

Section 12: Responses to General Questions 23

Section 13: Conclusion 32

Section 14: References 33

Appendix A 34

Appendix B 35

FOREWORD

The AADA welcomes the opportunity to make a submission in response to the Review of the Franchising Code of Conduct (the Code), Consultation Paper. The AADA is the peak automotive industry body representing Australia's franchised new car Dealers. There are more than 3,000 new vehicle dealerships in Australia employing more than 56,000 people directly and generating $68 billion in turnover and sales with a total economic contribution of over $17 billion.

"It will be apparent from the reasons that I am publishing that the applicants were successful on many issues of fact but lost on the law, essentially".

"given the facts of this case leading to an adverse result for the applicants, it may be that further consideration needs to be given to the terms of the franchising code and possible modification, but that is a matter for another day and, obviously, in another forum".

The Hon Justice Jonathan Beach, Federal Court of Australia.

AHG WA (2015) PTY LTD T/A MERCEDES-BENZ PERTH AND WESTPOINT STAR MERCEDES-BENZ and OTHERS And MERCEDES-BENZ AUSTRALIA/PACIFIC PTY LTD

The concept of a power imbalance in the automotive franchising sector is well established, but the franchising regulations in Australia continue to leave new car Dealers exposed to exploitative behaviour. The fact is that the Code in its various iterations has not served franchisees well and does not offer the level of protection enjoyed by franchised new car Dealers in countries. For example, in the United States, where Dealers enjoy strong protections against termination and non-renewal and are provided compensation for loss of goodwill and the EU where there are requirements for agents to receive compensation for loss of goodwill upon cessation of the agreement. This lack of domestic protections ultimately leaves Australian businesses more vulnerable to exploitation than their international counterparts.

The judgement in the recent court action between Mercedes-Benz Australia/Pacific Pty Ltd and the majority of its Dealers has alarmed franchised new car Dealers across Australia. AADA would argue that the law has allowed Mercedes-Benz to essentially change the nature of a decades-long business relationship to its benefit and with no compensation to those Australian businesses which have invested time, effort and substantial capital in growing the Mercedes-Benz brand to where it is in Australia today. With Justice Beach stating that *"... the shift to the agency model was in large part a case of franchisor opportunism because [Mercedes-Benz Australia] took advantage of its position after the dealers had made significant investments, and it intended to appropriate the gains in the industry margins associated with the move to the agency model;"*

The case touched on many of the themes which have been raised in franchising reviews and inquiries over the years - non-renewal, goodwill, good faith, and unconscionability to name a few.

From our perspective, the comments made by Justice Beach quoted above, underscore the crux of the matter. **The current franchising laws allow exploitative behaviour**. While not every Original Equipment Manufacturer (OEM) exploits their Dealers, the power to do so exists, and it may only take a change in management, (which in Australia occurs frequently for some brands due to our status as a small market in which overseas executives are sent to develop experience before moving onto bigger and better things in more prominent markets) or strategy by an OEM for them to utilise the power.

OEMs enjoy superior bargaining power in comparison to their Dealers through the provision of one-sided, standard-form contracts, offered on a take it or leave it basis. Dealers make significant investments in their businesses, often resulting in a dependency on the ongoing right to run the franchise. With this dependency, the Dealer loses their bargaining power, and the more sunk investment the Dealer commits, the more vulnerable they are. They are vulnerable because OEMs have extensive powers to bring franchise agreements to an abrupt end using non-renewal and termination powers. Ironically, significant portions of the investments Dealers make are as a result of non-negotiable requirements prescribed by the OEM.

OEMs can exploit this vulnerability to make excessive demands of their Dealers, and often Dealers feel like they have no choice but to comply or risk losing their franchise and foregoing the goodwill they have built up in their business. Even when Dealers are subject to unlawful behaviour, they are dissuaded from pursuing OEMs in the courts due to the expensive, time-consuming, and emotionally draining nature of the legal system, a system which favours OEMs and their endless legal resources. On occasions that Dealers have pursued a claim through the courts, they have been on the receiving end of the very high bar required to prove unconscionable conduct or failure to act in good faith.

The automotive industry is undergoing an unprecedented period of change and the AADA's consistent position is that any changes imposed on Dealers by their OEMs should be done in a fair and transparent manner with compensation where appropriate.

The AADA has put forward a range of recommendations which we believe are fair and reasonable and will in no way inhibit the industry's ability to prosper and serve the needs of our mutual customers.

James Voortman
Chief Executive Officer

Section 2

AADA RECOMMENDATIONS

1. OEMs should be required to show cause for termination and non-renewal of Dealer Agreements.

2. Franchised new car Dealers should be provided with a mandatory minimum term of 5 years with an option to renew for one further term.

3. The Code should abolish the ability to waive the 12-month notice period for Dealer agreements which are less than 12 months.

4. The Code should require Franchisors to provide compensation for goodwill upon non-renewal/termination.

5. Unfair Contract Term protections should be extended to ALL franchisees.

6. Unfair Trading Practices protections should be extended to ALL franchisees.

7. The Government should develop guidelines such as those in the EU which specify how agency models are allowed to operate.

8. Part 5 of the Code should be extended to Truck Dealers as well as motorcycle and farm machinery Dealers.

9. The definition of 'New Vehicle Dealership Agreement' under Part 5 should be amended to address the issue of separate agreements falling outside the scope of the regulations.

10. The Government should explore ways to encourage OEMs to sign up to arbitration akin to the Canadian automotive industry-led model.

11. The development of a Federal Small Business Codes List in the Federal Circuit Court of Australia which includes ALL franchisees.

12. OEM investment disclosure obligations should be enhanced to allow franchised new car Dealers to make informed business decisions, through the provision of a detailed business case or prospectus.

13. Explore whether franchisees should be offered protections as investors as is the case for retail investors.

Australia

3,026 Dealerships

Economic Contribution

56,829
Dealer Employees

$6.80 billion
Dealer Wages

$3.59 billion
Tax Contribution

$17.30 billion
Total Economic Contribution

Section 3

AUTOMOTIVE INDUSTRY CONTEXT

The Australian automotive new car retailing industry can be broadly defined into two categories. Vehicle manufacturers or OEMs, which are largely multinational businesses which supply vehicles into the Australian market. Car Dealers, which are generally Australian privately owned or family businesses who enter franchise agreements to purchase vehicles from these manufacturers to retail to Australian consumers. This system is known as the franchising model and has underpinned the way in which Australians are able to buy new cars for more than a century.

While the Dealer-OEM relationship is considered part of the wider franchising sector, there are key features which make the automotive industry unique from the run of the mill franchise. Features, such as the scale of investment and relative size of our franchisors, have been covered in previous submissions and we elaborate on them in the section about extending Part 5 to truck Dealers.

The history of the sector is characterised by too many examples whereby franchisors exploit the power imbalance which characterises their relationship with franchisees. In recent times, we have seen headlines around the way in which General Motors (GM) terminated the Holden brand and exited the Australian market, leading to a Senate Inquiry which extraordinarily censured GM. The Inquiry was later extended to all relationships between OEMs and Dealers which heard examples about how Honda and Mercedes' move to an Agency model affected their Dealers. The Government subsequently introduced Part 5 of the Code to better protect motor vehicle Dealers in 2020 and further strengthened it in 2021. Unfortunately, these protections have not fundamentally changed the power advantage that OEMs hold over Dealers. We are calling for additional changes that go further and replicate some of the protections which exist in markets such as the US.

This is particularly important given the changes currently sweeping through the Australian automotive industry with a shift to Electric Vehicles (EVs), the arrival of several new OEMs and the appetite of OEMs to experiment with new distribution models, such as the agency model. This transformation holds some degree of risk for Dealers. Risk which could be compounded by exploitative and opportunistic behaviour by OEMs.

This review will be presented with a set of alternative views on the lack of need for automotive franchising reform by other parties. Claims will be made by others that Dealers are well resourced and are increasingly large corporations. The facts are that while Dealers are more sophisticated than the typical franchisee, they are minuscule compared to the resources and sophistication of any OEM. The percentage of Dealer groups which own between one and five franchises are 75 per cent. Another 15 per cent own between 6 and 10. Less than 2 per cent of groups can be labelled large Dealer groups with more than 26 franchises.[1] Claims will be made that additional regulations will drive OEMs away from Australia. The reality is that Australia is a very profitable market for OEMs and that even since Part 5 was introduced in 2020 and amended in 2021, a relatively large number of newly arrived OEMs have decided to establish a presence in Australia.

It must be said that it is an unfortunate reality that many of our comments, along with those of our members, some of who will be making submissions of their own, have to be made under a blanket of confidentiality and are carefully vetted to prevent Dealers being identified. Dealers fear repudiation by OEMs who like to keep their behaviour towards franchisees a secret. This places some limitations on the detail of the content that is able to be submitted, however the consequences of a Dealer speaking out against the behaviour of a franchisor can be drastic and extend to a Dealer potentially losing their business if they speak up. The risk has curtailed Dealers willingness to make comment in this Review, as it has in previous reviews. The AADA would strongly encourage Dr Schaper and the review team to meet with Dealers directly and hear first-hand their examples of unfair and unconscionable behaviour, in the safety of in camera sessions that should serve to mitigate the risks of punitive actions by the OEMs.

Section 4

INSECURITY OF TENURE AND FRANCHISOR USE OF TERMINATION AND NON-RENEWAL POWERS

There is a significant power imbalance between OEMs and Dealers in the franchising relationship, and while this power imbalance permeates every aspect of the relationship, one of the most prominent examples is the issue of tenure.

Insecurity of tenure for franchised new car Dealers is demonstrated in the term lengths of the franchise agreements provided to Dealers. These agreements can be given with a term as short as one year. Even the standard agreement term of 5-years pales is inadequate when you consider the investment required and if you consider that franchisors like McDonalds offer terms of up to 20 years. While a Dealer may feel reluctant to enter into an agreement of only one year, they are often placed in a position of disadvantage in the negotiation process as they have invested significant capital and resources over a long period of time into a brand and have an obligation to their employees and customers. As such, Dealers are placed in a position where they must accept the short agreement term or lose the brand altogether.

The expenditures Dealers are required to make by their OEM's to meet their franchise and building requirements are significant. Particularly the requirement to build and fit out a purpose-built facility for a particular brand. These cannot be easily converted to another brand or new retail model which makes these investments especially onerous on the Dealer if they are only being provided a short agreement term or an agreement with no right of renewal. The AADA considers that due to the large capital investments required by OEMs, Dealers should have a mandatory minimum term of 5 years with an option to renew for one further term.

This is what we see in the Oil Code and would give much greater certainty to Dealers to invest in a brand. It would also go some way to providing certainty for the more than 56,000 people employed in dealerships throughout Australia. It would benefit consumers who generally purchase vehicles with the expectation that they will return to the selling Dealer to service and repair their vehicle when needed. There are countless examples of OEMs closing a dealership in a specific area, leaving customers with longer travel times to have their cars serviced or have recalls rectified and this can have a significant impact on customers in rural and regional areas.

AADA is concerned that the regulations around end of term obligations introduced on 1 July 2020 may further encourage shorter term agreements. Under those regulations, OEMs and Dealers are now required to provide a reason when they do not renew an agreement. They are also required to provide 12-months' notice if they intend not to renew an agreement. Unfortunately, the regulations allow the 12-month requirement to be waived if the agreement is for a period of less than 12-months, in which case the notice period is six months. It also reduces the notice period to one month if the agreement is six months or less. There is a real risk that this element of the regulations will result in OEMs offering shorter terms so that they can provide the shortest notice period possible.

Insecurity of tenure is compounded by the sweeping powers of non-renewal and termination available to franchisors. Almost every Dealer agreement in Australia has a clause giving the OEM power to issue a non-renewal without

cause notice. While the AADA acknowledges that most franchise agreements have a limited term, there is an implied renewal in these agreements so long as the franchisee is meeting their performance obligations. And while this arrangement works well in many cases, when the franchisee-franchisor relation sours or the franchisor wants to cull franchisees from its network, franchisees can often be left with no recourse to challenge a non-renewal decision.

The AADA considers that the recent Code changes, particularly the new car Dealer provisions do go some way towards protecting franchisees, for example, the need for franchises to have an opportunity to make a return on investment, but more needs to be done to ensure that franchisors have good cause justifying non-renewal of a franchise agreement.

The ability for an OEM to non-renew a franchise agreement with no cause places the Dealer at a significant disadvantage when negotiating on franchise agreement terms. There are several examples where a right of renewal for franchise agreements has been mandated to overcome the power imbalance between big businesses and the smaller businesses they deal with, such as the provisions in the Oil Code mentioned above.

These types of provisions would go some way towards correcting the power imbalance between the OEM and Dealers and should be further explored in the Review process.

Inclusion of clause 28 in the Franchising Code

The AADA also submits that 'no fault' termination rights permitted by clause 28 should not be allowed to apply to Dealer Agreements because OEMs already have extensive termination rights for unsatisfactory performance by Dealers.

Clause 28 of the Code permits a manufacturer/distributor to include a term in the Dealer Agreement to terminate the Dealer Agreement at any time by giving reasonable notice where this is no breach of the part of the Dealer.

The AADA considers that this clause if exercised, prohibits a Dealer from effectively assessing their opportunity to make a return on investment during the agreement (which is mandated in the Code) and as such 'no fault' termination should be excluded from applying to new car Dealer Agreements.

GOODWILL

The AADA considers that the Code is ineffectual in protecting the goodwill that Dealers invest in when buying and developing their dealership businesses and is in need of reform in this regard. This lack of recognition of goodwill once a franchise agreement ends enables franchisor opportunism, in which the franchisor exploits its rights of termination and non-renewal to pressure a franchisee to conform with its wishes or face the potential loss of their franchise and the goodwill built up in their business.

In the case between Mercedes-Benz and its Dealers, Justice Beach made the distinction between accounting goodwill and legal goodwill. He ruled that the former had no standing in law and that legally goodwill was tethered to the Dealer agreement identifying a number of current inadequacies in the Code with respect to the protection of goodwill. The AADA believes this needs to be addressed urgently.

The fact is that goodwill is a well-established source of value in the automotive retail industry. Apart from the capital investment Dealers make in their business, goodwill is the other significant investment Dealers make. Dealers pay for goodwill when purchasing a dealership from another Dealer and they also make ongoing financial investments in their goodwill by developing their dealership business including their customer relationships. Vehicle manufacturers also recognise goodwill when selling company-owned dealerships. **Goodwill is an accepted part of the calculation in the value of the business when it comes time to buy or sell a dealership**.

AADA submits that the Code should be amended to legally recognise the goodwill franchisees build up in their businesses, particularly in situations where a franchisor has used a non-renewal or termination power to take control of a franchisees' business. The move to an agency model is a good example whereby an OEM significantly changes the business model in order to leverage the franchisees' sunk investment in capital, time and effort, allowing it to completely take over or assert more control of the business and improve the franchisor's earnings at the expense of the franchisee. The value of the franchisees' business is significantly diminished by the erosion of goodwill which has been appropriated for no cost by the franchisor.

A series of franchising reviews over the last half a century have considered goodwill with some making recommendations about providing compensation for goodwill upon non-renewal/termination while others have explored arrangements for sharing goodwill (further exploration of the findings of these committees can be found on pages 2-3 of the attached appendix '**Adequacy of protection of goodwill, HWL Ebsworth, 2023**') but to date, no further progress has been made in ensuring the protection of franchisee goodwill in Australia.

The closest thing is Clause 46A (1) (b) in Part 5 of the Code which requires compensation for goodwill in the event of a Dealer Agreement being terminated prematurely. However, even this recent addition of clause 46A does not provide adequate protections to Dealers with respect to the loss of opportunity in selling established goodwill in the circumstances described in that clause.

Section 5

The concept of compensation for goodwill upon termination is gathering traction in other parts of the world. In the EU, **Council Directive 86/653/EEC** governs commercial relationships between agents and principals. The Directive is obligatory for all EU Member States and among other things provides a requirement for agents to receive compensation for loss of goodwill upon cessation of the agreement. A number of countries in the EU have applied the goodwill compensation element of **86/653/EEC** to franchise contracts while in other member states the courts have found franchisees to be entitled to similar rights.[2]

The United States also has examples whereby franchisors are legally obliged to pay the franchisee for the 'local goodwill' the franchisee helped generate during the course of the relationship - Hawaii, Illinois and Washington all have such requirements. Of more consequence are the limits placed on the US franchisors, particularly OEMs under state automotive franchising laws to issue termination and non-renewal notices - these go a long way to protecting franchisee goodwill. Further detailed information on US franchising regulations is provided in Appendix A.

Further detailed analysis of the need for recognition of goodwill and compensation is provided in Appendix B.

Section 6

UNFAIR CONTRACT TERMS AND TRADE PRACTICES

The AADA is encouraged by and welcomes the recent changes to Unfair Contract Terms (UCT) laws which take effect from 9 November 2023. These changes will strengthen protections for small businesses from unfair terms in standard-form contracts and provide increased protections for Dealers who qualify under the new thresholds. However, many Dealers are not covered by these protections and the AADA has for some time been calling for ALL franchisees to be included in these protections.

Many Dealers do not qualify for the new protections due to the less than 100 employee threshold. Furthermore, in New South Wales, the *Motor Dealers and Repairers Act 2013* ensures that all Dealers are protected from unfair terms in contracts for the supply of motor vehicles by manufacturers to motor Dealers.

So as an industry, Dealers across Australia are operating under a patchwork approach to UCT protections, whereby coverage is determined by the size of your workforce and the location of your business. It seems absurd that a Dealership employing 101 people will not be protected against a Fortune 100 company which generates revenues of hundreds of Billions of Dollars and employs half a million people. It seems equally absurd that a Dealer operating in Wodonga will not enjoy UCT protections while a Dealer of the same size in Albury will be protected.

We believe UCT protections should be extended to ALL franchisees given the power imbalance which has been well documented in a series of franchising reviews. Such a broadening of the protections will also serve to benefit the smallest most vulnerable Dealers, as the most likely scenario in which Dealers would challenge an OEM on UCTs is one in which a large proportion of the franchisees (big and small) take united action. Unless an entire Dealer network enjoys UCT protections, the appetite to try an enforce those protections is likely to be somewhat stymied.

The AADA also notes the current consultation on possible reforms to the Australian Consumer Law. These reforms address currently unregulated Unfair Trading Practices (UTP) which currently fall outside the scope of the Australian Consumer Law, despite causing considerable harm to consumers and small businesses.

The AADA considers that protections against UTP should be extended to ALL franchisees due to the inherent power imbalance in their commercial arrangements with their franchisor. The recent case between Mercedes-Benz Australia Pacific and its Dealers is the most recent in a long line of examples highlighting the almost impossibly high bar for demonstrating unconscionable conduct and further highlights the need for protection from practices that are harmful but do not reach the legal threshold for unconscionable conduct.

Similar to UCTs, Dealers in NSW are afforded protections against unjust conduct under the *Motor Dealers and Repairers Act 2013*. We believe UTP protections should be extended to ALL franchisees given the power imbalance which has been well documented in a series of franchising reviews.

The AADA will submit a response to this consultation paper and would welcome the exploration of how franchisees can be better protected from UTPs.

AGENCY DISTRIBUTION

Automotive businesses are beginning to rethink their vehicle sales and distribution models with some brands opting to convert their existing Dealers into agents, who act on behalf of the OEM and are remunerated through a fixed fee paid to dealerships on each vehicle that is delivered. Several OEMs are now distributing vehicles through a fixed-price agency model in Australia.

The AADA has always said that it does not dispute the OEM's right to determine their favoured distribution model, but there needs to be guidelines on how OEMs transition their Dealers to agency and how agency models are allowed to operate. The Government needs to follow other jurisdictions and consider policy requirements for the emergence of agency models in the automotive sector. It needs to address the following:

- **Genuine vs Non-Genuine Agents**

There should be no risk for agents. OEMs employing the agency model are doing so to benefit from competition law exemptions, specifically the retail price maintenance provisions of the Competition and Consumer Act. Internationally there have been significant concerns with what they term as genuine agency agreements or non-genuine agency agreements. As a result, jurisdictions have sought to define what constitutes an agent as compared to what is a Dealer. Some elements which they have identified to clearly delineate the differences between the role of an agent compared to a Dealer are, that the agent does not bear the risk of the transactions in which he intervenes; that he does not keep a large stock of products at his own expense (he may have some stock of his own); that he does not bear the cost of organising customer services (although he may have employees at his expense for his promotional and administrative tasks, for example).

- **Blended Sales Models**

AADA is increasingly concerned about use of blended sales models, where OEMs require some products to be sold on a regular franchise model basis, but other products to be sold on an agency basis. One example of this is several brands requiring Electric Vehicles to be supplied on an agency basis while traditional ICE cars remain on the franchised system. AADA argues that this allows an OEM to essentially compete with its franchisees while in effect using the franchisee's facilities and sunk investment to do so. OEMs should not be allowed to employ blended models - it blurs the lines around their ability to gain exemptions from retail price maintenance provisions; it potentially allows OEMs to saddle the Dealers with risk on undesirable products while cherry picking the best and most profitable models for its own purpose to be sold at a fixed price.

- **Legal Liability**

Related to these issues of risk is the question of legal obligations. Under the current environment automotive Dealers have a joint liability with the OEM under the Australian Consumer Law. In particular, industry and consumers need clarification on consumer law obligations in relation to agency. Agents do not own or manufacture the stock they are selling and as a result are not suppliers. They should not hold the legal responsibility for refunds and replacements under the Australian Consumer Law.

THE NEED TO EXTEND PART 5 OF THE CODE TO INCLUDE TRUCK DEALERS

When Part 5 of the Code was put in place it only applied to the franchised new car sector. We believe this was an unfortunate oversight and would submit that the factors which characterise the relations between OEMs and car Dealers also exist in the relationship between OEMs and truck Dealers.

Over the years in making the argument for specific protections for automotive Dealers, we have identified several factors which make the OEM/car Dealer relationship different to the typical franchising relationship. The same is true of the OEM/Truck Dealer relationship, including:

- High levels of capital expenditure required of truck Dealers to invest in expensive facilities, stock, tools and suitably qualified and trained personnel.
- Unique facilities such as bespoke showrooms and workshops which are distinctive and very difficult to repurpose.
- Truck Dealers are significant employers relative to other franchisees and have staff across various departments such as sales, service and repair and finance and insurance
- OEMs are all subsidiaries of powerful offshore multi-national companies which are among the largest in the world.
- Trucks are an incredibly high value product which are mechanically and technologically sophisticated relative to other goods.
- There is an extended after sales relationship between a truck Dealer and its customers.
- Unlike most franchised businesses, Truck Dealers perform a vital community service in the form of vehicle safety recalls - a phenomenon which has been growing in recent years.

As in the new car sector, new truck Dealers often enjoy good relations with their OEMs. Equally, just as in the new car sector prior to the introduction of Part 5, there are many examples of franchisors who:

- Dictate unfair contract terms from which many truck Dealers have no protection
- Set burdensome and often unnecessary administrative tasks which they use as leverage in allegations of Dealer non-conformance
- Offer one-sided contracts with tenure which provides no opportunity for a return on Dealer investment prescribed and refuse any attempts to negotiate reasonably
- Non-renew Dealer agreements with as little as six month's notice and no obligation to provide a reason for non-renewal

Dealer Agreements in the truck industry generally provide no provisions for compensation in the event of early termination or non-renewal and because of the lack of protections, Dealers may be threatened with short term agreements if Dealers refuse to comply with requirements introduced by the franchisor.

The power imbalance experienced in the car sector is exacerbated in the trucking sector because the truck market is even

more concentrated. Facility requirements for truck Dealers are generally like those of car Dealers with regards to signage and dealership design but truck Dealers have to be considerably larger and have bigger workshops. These often more onerous requirements translate to truck Dealers having large sunk costs in their business and this can be used opportunistically by some franchisors to force through their wishes and get Dealers to sign unfair agreements.

The highly concentrated nature of the sector also makes it very difficult for Dealers to speak up and as often there might be only one or two Dealers in an entire region or state, there is no opportunity for Dealers to collectively bargain or negotiate. Because of the threatening behaviour of some franchisors, Dealers are often afraid to try and exercise their rights and they know that trying to do so through a collective representative body such as their Dealer Councils is not an option as franchisors are able to quickly identify who the complaining Dealer is.

It is unfortunate and most likely an oversight of previous reviews of the Code, that the protections contained in Part 5 of the Code introduced in 2020, do not include coverage for truck Dealers. The impacts of the power imbalance are the same for truck Dealers as are they are for car Dealers, but due to the more concentrated sector, they are sometimes worse. Truck Dealers make equally sizeable investments in their businesses, employ large numbers of staff and provide essential services to keep Australian transport and logistics running. The need for stronger protections is chronically overdue and should be corrected as a matter of urgency.

This could be accomplished through a simple change to the definition of "new vehicle dealership agreement" under Division 2, part 4:

new vehicle dealership agreement means a motor vehicle dealership agreement relating to a motor vehicle dealership that predominantly deals in new ~~passenger~~ vehicles ~~or new light goods vehicles (or both)~~.

While the AADA does not represent motorcycle Dealers or farm machinery Dealers, some of our car and truck members have these businesses within their portfolio of brands. We understand that they face many of the same challenges articulated above and would support them being offered the same protections under Part 5 of the Code.

SEPARATION OF AGREEMENTS

The AADA has significant concerns with OEMs attempting to avoid their obligations under the Code by separating the agreements provided to Dealers for sales and servicing and parts.

In normal circumstances, an OEM generally provides a Dealer Agreement which covers vehicle sales, parts sales, sales of accessories and service operations. However, there are now instances of OEMs offering specific agreements for sales and separate agreements for parts and services, calling into question whether the Service and Parts Agreement is in fact a Franchise Agreement.

This is an incredibly concerning development, which threatens to undermine the intent of the recently introduced regulations for new car dealerships in the Code. It is well accepted that the relationship between Dealers and OEMs encompasses all the departments of a dealership and the legislation in a number of sections of the Code references aspects from the service and parts side of the business.

Clause 46A (1B) talks about compensation from direct as well as indirect revenue as well as the costs of winding up the business. Clause 46A (2) references the buy back or compensation to the franchisee for spare parts and special tools. Again, clause 49 (2) mentions a plan for managing down spare parts and service and repair equipment, while clause 49 (3) mentions reducing stock of spare parts.

The large investment required by Dealers and the great risk they take on in entering into these franchise agreements is not limited to the sales part of the business and extends into the service department where the Dealer is mandated to build fit-for-purpose facilities and purchase expensive OEM-approved servicing equipment and genuine parts. There are also significant training requirements in the service department mandated by the OEMs and a number of other OEM imposed requirements, such as Dealers being required to hold a minimum number of parts.

Allowing OEMs to simply offer separate Service and Parts Agreements, in order to escape the obligations under the Code for this area of the relationship, will place Dealers and the significant investments they make at risk and is not in line with the intent of the changes to the Code.

AADA has previously put forward a simple change to the definition of a New Vehicle Dealership Agreement under Part 5 to resolve this issue.

Recommended Motor Vehicle Dealership definition:

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

b) includes a business of:

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

ii) selling motor vehicle parts for motor vehicles sold by the business;

iii) servicing and repairing motor vehicles sold by the business; or

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

DISPUTES

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

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

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

Taking on an OEM in the courts is a grim proposition even for a well-resourced Dealer. OEMs have large internal legal departments, and their resources allow them access to the best legal representation money can buy for as long as they need it. It is not only Dealers who get dragged into these disputes, as parties related to them may be subpoenaed. The AADA was among the related parties to be subpoenaed in the case between Mercedes-Benz Australia/ Pacific PTY Ltd and its Dealers, with requests being made for the Association's communications with Parliamentarians. The need to appoint legal counsel came at significant cost to the AADA and was quite distressing as we were not party to the case.

A court challenge can take years at great financial cost, a point OEMs have often made to Dealers considering such action. OEMs are only too aware of the reluctance of Dealers to challenge them through the courts and as a result, there is very little incentive for them to engage in good-faith mediation. There are currently four cases of Dealers engaged in court action with OEMs. These cases demonstrate the challenges of taking on a well-resourced multi-national corporation, as OEMs find ways to drag out the process.

Recent attempts to reach an industry-based solution have not been successful. The AADA, the FCAI and the MTAA concluded an MoU which committed us to encouraging our respective members to include in their Dealer Agreements an arbitration process for certain disputes. While the Industry groups worked collaboratively and in good faith, we have yet to learn of any Dealer Agreement which has adopted the limited arbitration proposal.

Section 10

The AADA is cognisant of the constitutional limitations of mandating arbitration as a form of dispute resolution. While there are examples of comprehensive industry-led solutions in Canada, to replicate this in Australia would seemingly require the Government to strongly encourage OEMs to sign up to such a proposal.

Another option which may have merit is the advocacy by the Australian Small Business and Family Enterprise Ombudsman for a Federal Small Business Codes List to be created in the Federal Circuit Court of Australia, and expanding such an initiative to all franchisees.

Part 5 of the Code allows franchisees to request multi-franchise dispute resolution. While this recent addition is welcomed, its efficacy is limited by the fact that OEMs are not obliged to engage in such a process. The AADA is not aware of this clause of the Code being used by franchised new car Dealers since its inception. Clause 52 of the Code should be strengthened to compel OEMs to participate in multi-franchisee dispute resolution.

Section 11

FRANCHISEES AS INVESTORS

It is easy to characterise franchising as a relationship where a franchisee benefits from the use of a brand for a period. Franchisees are also investors and in the case of the automotive industry, Dealers are major investors who commit significant sums of capital in buildings and facilities, purchasing equipment and tools, training their staff, and developing well run businesses which provide first class service to their customers. Simply put, franchising is an investment model. A collective network of Dealers are often responsible for the investments which develop a national network of automotive retail sites spread across Australia.

Current disclosure obligations on franchisors may not be sufficient in outlining the investment required by the franchisee throughout the agreement term, which makes determining if the agreement provides a sufficient opportunity to make a return on investment, very difficult. Due to the significant financial investment requirements, often in the millions to tens of millions of dollars, the investment disclosure obligations should be enhanced to allow franchised new car Dealers to make informed business decisions.

The question should also be asked as to whether franchisees should be entitled to protections similar to those provided to investors under the Corporations Act. The AADA believes this review should explore this concept but that any such change should be made in addition to a more effective Franchising Code of Conduct.

AADA responses to the consultation questions are detailed below.

GENERAL QUESTIONS

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

The AADA considers that the automotive franchising cases that have gone before the courts in recent years, in particular the recent case brought by Mercedes Benz Dealers, highlight significant issues related to the enormous power imbalance between automotive franchisors and franchisees. This case demonstrated how OEMs use their size and significant resources to exploit the relationship between themselves and the franchisee. Dealers can be subjected to non-renewal and extremely short agreement terms, and with such a high bar for unconscionable conduct, it is often extremely difficult for franchisees to pursue any recourse against these actions.

There is significant change happening in the automotive industry and an increasing number of OEMs changing their distribution models with no input from their franchise network. OEMs are seeing an opportunity to take back much of the profit from their businesses while continuing to utilise the facilities investment, goodwill, and business acumen of the franchisee. There is no acknowledgement of the sunk investment made by the Dealer and the Dealer often has no resources to request compensation.

The AADA considers that this review of the Code must explore this issue related to changing distribution, commonly known as 'agency' and seek ways to ensure that franchisees are not put at a disadvantage due to these changes.

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

The AADA considers that the Code is an essential component in the regulation of Australian franchisees and franchisors and welcomes the addition of the new car dealership provisions enacted in 2021. However, the AADA considers that there remain significant regulatory gaps which urgently need to be addressed, such as the issues highlighted in detail above related to goodwill, security of tenure, unfair contract terms and unfair trade practices protections, changing distribution models, inclusion of other automotive franchisees, separation of agreements and fit for purpose dispute resolution.

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

As described above, the increasing prevalence of online sales models as well as moves to 'agency' models, has significantly changed the way in which some automotive brands sell their vehicles. This change in distribution often comes at the expense of Dealers who have invested heavily in a particular brand, their employees and the customers and community, only to have that goodwill taken from them with no compensation.

Another area where technological innovations may affect the operation of the Code would be the increasing penetration of EVs. Dealers continue to be

supportive of the move to EVs and understand that in order for Australia to meet its climate change targets, transport emissions will need to be significantly reduced. However, the rise in EV sales has meant that Brands have opted to opportunistically sell these through an agency model, but kept the franchise model for traditional fuel-burning vehicles. This change can result in a few issues related to franchisors competing with their own franchisees in the new vehicle retail market. This is explored in further detail above.

New technologies and software-defined vehicles are changing the automotive market rapidly. The supply, sale and servicing of cars now extends to communications, connectivity, over the air updates, data collection, and big data analysis of vehicle use and customer preferences. To keep up with digitisation and connectivity it could be argued that the franchise agreement should also follow the product and include support for data sharing agreements between OEMs and Dealers. The Review should examine the impacts of data sharing arrangements between OEMs and Dealers and consider how these agreements apply to the Code to ensure that franchisees have access to vital information necessary to perform duties outlined in the franchise agreement.

QUESTIONS – THE SCOPE OF REGULATION

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 AADA considers that the Code remains appropriate and captures the uniqueness of the automotive franchising sector in the Automotive provisions. However, it is clear that there are other automotive franchising businesses that should be covered under the Automotive provisions, such as truck Dealers. This could be accomplished through a simple change to the definition of "new vehicle dealership agreement" under Division 2, part 4:

new vehicle dealership agreement means a motor vehicle dealership agreement relating to a motor vehicle dealership that predominantly deals in new ~~passenger~~ vehicles ~~or new light goods vehicles (or both)~~.

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 AADA has no comment.

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 AADA highlights the comments put forward in the *'Regulation Impact Statement, Franchise relationships between car manufacturers and new car dealers, December 2018'* "the Franchising Code and industry action to date have not been able to address matters over insecurity of tenure, end of term arrangements when dealership agreements are not renewed and dispute resolution over end of term arrangements, further government action is warranted."

Truck Dealers and other automotive franchisees operate in a very similar manner and experience the same issues outlined above which warranted government action, specifically the inclusion of the Automotive provisions in the Code. Some brands that manufacture cars for the Australian market, also manufacture trucks and or motorcycles, as such, the franchise agreements for these other types of vehicles are structured in the same way and many of the risks carried by car Dealers are carried by truck, motorcycle, and farm machinery Dealers.

The AADA considers that automotive-specific protections should be extended to cover Dealers which distribute vehicles such as trucks, motorcycles and farm machinery.

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?

Yes, the AADA considers that these agreements between OEMS and dealerships that relate only to service and repair work should be considered franchise agreements. The AADA considers that when introducing the Automotive specific provisions in the Code, the intention was for servicing and parts to be captured under these regulations. This is evident throughout where the Code specifies buy back or compensation to the franchisee for spare parts and special tools and mentions a plan for managing down spare parts and service and repair equipment, while clause 49 (3) mentions reducing stock of spare parts.

The AADA considers this separation of agreements to be a concerning development which threatens to undermine the intent of the recently introduced regulations for new car dealerships in the Franchising Code and if not clarified include servicing and parts, will allow OEMs to avoid their obligations under the Franchising Code.

The AADA proposes additional wording be inserted into the Code to clarify the capture of servicing and repair services:

Division 2 - Definitions

4 Definitions

(1) In this code:

motor vehicle dealership:

a) means a business of buying, selling,

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

b) includes a business of:

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

ii) selling motor vehicle parts for motor vehicles sold by the business;

iii) servicing and repairing motor vehicles sold by the business; or

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

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?

It appears very clear that Agency sales agreements in the automotive sector are subject to the provisions of the Code.

QUESTIONS - BEFORE ENTERING INTO A FRANCHISE AGREEMENT

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 AADA draws attention to two issues requirements of the Code that ensure franchisors make information available to franchisees prior to entry into a franchise agreement, unexpected investments and sufficiency of disclosure.

Unexpected investments

One of the most difficult disclosure issues for new car Dealers is the arrival of unexpected investments that occur despite the disclosure requirements of the Code. Such as the requirement to make new investments in products, facilities, equipment, tooling, promotions or training during the term of an agreement.

Franchisees often do agree to such expenditure because it is requested by the franchisor, however, these requests for new expenditure are not specifically included in the disclosure document and can arrive unexpectedly.

Disclosure of investment costs are not always known at the time of the disclosure document being issued. For example, Dealers are currently faced with such a situation with a transition to electric vehicles and requests to provide charging station equipment at their dealerships. This can be an unplanned cost and the expenses of fast charging equipment for

electric vehicles become orders of magnitude higher where grid upgrades are also required to supply the necessary power to dealership premises. It is often unknown to Dealers how they will recoup the cost of an expensive electricity upgrade for electric vehicle charging equipment.

Franchisees need timely communication of any new investment requests which may arise during the term of the agreement, and a clear analysis of how a return on investment will be achieved during the life of the franchise agreement. Keeping in mind that there is no business goodwill available after the franchise agreement is finished. When the franchise is completed, trading ceases, and the prospect of returns on often bespoke investments made during the franchised period may have disappeared.

Sufficiency of disclosure

Disclosure also brings with it the question of how a franchisee will obtain a "reasonable opportunity to make a return, during the term of the agreement, on any investment required by the franchisor" as is required by the inclusion Clause 46 B of the Code specific to new vehicle dealership agreements.

Dealers are required to undertake significant financial reporting on their businesses to their franchisor, but this is not always a two-way street. The AADA considers that the current Disclosure obligations on franchisors may not be sufficient. OEMs undertake significant analysis and have comprehensive financial and operational information at hand and this should be made available to potential franchisees. This could come in the form of an investment prospectus, which would go some way towards helping Dealers make more informed investment decisions in a brand.

Further, if new operating models are being considered, e.g. agency, it should be incumbent on the OEM to be able to provide comprehensive disclosure outlining the opportunity for the Dealer to make a return on investment under the new model. The AADA submits the onus on Disclosure and responsibility under Clause 46B should be on the OEM to ensure that any new distribution models brought to market should come with an outline of a sustainability opportunity to make a return on investment during the agreement term.

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?

The AADA considers that Unfair Contract Terms (UCT) Protections should be extended to all franchisees. Under the current regulations, many dealers do not qualify for the new protections due to the employee threshold. The comparative size difference between the OEM and the Dealer creates a power imbalance when entering into a franchise agreement, which places car Dealers at greater risk of being subjected to UCT, as such, all franchised new car Dealers should qualify for UCT protections, irrespective of the number of employees or annual turnover. If a term is unfair, the size of the respective parties concerned is of no consequence.

New South Wales has implemented protections for new car dealerships against UCTs regardless of business size or employee count. The AADA considers that these protections should be expanded nationally to protect all franchisees.

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

The AADA considers that many of the issues outlined in this submission could be addressed through improved requirements at the point of entry into a franchise agreement. A mandatory minimum term length and right of renewal would provide much-needed confidence to Dealers to engage in more robust negotiation with their franchisor throughout the agreement and access better dispute resolution without fear of termination or non-renewal.

New vehicle dealership agreements

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 AADA considers that these requirements do provide some degree of certainty for Dealers entering into franchise agreements. At this stage, many agreements have not been captured yet by these changes as they apply to franchise agreements entered into on or after June 2021, however, the AADA is aware of one example where the franchisor has included in the franchise agreement the clause relating to the opportunity to have a return on investment.

Notably, when this clause was included it included further clarification that the franchisee "accepts that construction, renovations, updates to premises fall outside of the Dealer's requirement to make a return on investment within Dealer Agreement tenure".

The investments that automotive franchisees are required to make in the physical premises are a significant portion of the overall investment required, and if these investments are not included in the return on investment stipulations in the Code, it ultimately waters down the strength of this requirement.

We have also seen clauses using words to the extent that "the Dealer agrees that this agreement represents an opportunity to make a return on their investment".

The AADA highlights these as examples of OEMs attempting to sidestep their requirements under the Code.

The AADA also highlights that many Dealers may be reluctant to press the issue of compensation and return on investment with their franchisor due to the significant power imbalance and better protection against non-renewal such as a mandatory minimum term and right of renewal would go some way to ensuring that Dealers can access protections provided under the Code.

QUESTIONS - ENDURING OBLIGATIONS IN FRANCHISE RELATIONSHIPS

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 AADA considers that more needs to be done to protect franchisees from structural and operational change by the franchisor. One example of this is the move to agency within the automotive sector which had significant impacts for franchisees that were heavily invested in the brand. The AADA accepts that franchisors must be able to adapt and innovate their business model, but this should not come at the expense of franchisees. Provisions in the Code to protect franchisees against significant structural or operational change without being compensated, would go some way towards correcting this issue which ultimately results from the significant power imbalance between franchisees and franchisors.

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

The AADA considers these changes to be welcome but have ultimately been nullified by the OEM's use of investment as a condition of renewal whereby an OEM will stipulate in a new or renewed franchise agreement that certain capital expenditure must be made. Due to the relatively short length of franchise agreements offered in the automotive sector and the significant power imbalance between Dealers and OEMs, the Dealer may consider that they are not likely to reasonably recoup the capital expenditure required, but will have little recourse to challenge this for fear of non-renewal of their agreement.

New vehicle dealership agreements

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 AADA welcomes the 2021 amendments to the obligation to act in good faith, however, considers that it is difficult for franchisees to demonstrate that a franchisor has not acted in good faith as this provision still allows for the franchisor to act in their own commercial interests. The AADA accepts that OEMs must be able to act in their own commercial interest and adapt to changes in the market. However, these changes should not be at the expense of their franchisees.

QUESTIONS – ENDING A FRANCHISE AGREEMENT

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 AADA welcomes these changes, however, is not aware of any automotive franchisees requesting early exit from their agreement.

New vehicle dealership agreements

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.

The AADA is not aware of any franchisor terminating a new vehicle dealership agreement early since the changes were introduced. Generally, the OEM will provide shorter term lengths for their agreements (1 year or less) to enable them to rationalise their network or change their distribution model without having to pay compensation due to early termination. The AADA has explored in further detail above, some areas where further regulation could go some way towards protecting franchisees from these practices and ensure they are paid compensation for early termination, particularly, ensuring a minimum 5 year agreement term, with a right or renewal for franchisees which continue to meet all these performance obligations in the agreement.

QUESTIONS – ENFORCEMENT AND DISPUTE RESOLUTION

ACCC and enforcement

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

The AADA considers it to be appropriate but highlights that the ACCC must be sufficiently resourced in this area to ensure the ability to enforce the Code effectively. The AADA also highlights the issue of anonymity when raising a complaint with the ACCC. Many Dealers often feel that they cannot approach the ACCC to make a complaint for fear of reprisal. If the ACCC allowed for complaints to be provided and handled confidentially, this would encourage greater engagement from franchisees when needed. The AADA urges this issue to be considered as part of the Review.

19. How useful and effective are the educational resources provided by regulators (such are 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 AADA considers that the educational resources provided by regulators are sufficient and readily available to franchisees to ensure they are aware of their rights and responsibilities.

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?

The AADA considers that the increase in penalties for contravention of the Code is appropriate, however is not aware of any instances of breaches due to being in existence for a short period (15 months).

Dispute resolution

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

The AADA is supportive of the role of ASBEFO in dispute resolution but considers that due to the voluntary nature of the dispute resolution process, OEMs often encourage disputes to be settled in court as a means to price out smaller franchisees from effectively resolving their disputes with their franchisor.

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 AADA is not aware of any multi-party dispute resolution being exercised or voluntary arbitration being exercised. However, the AADA is aware of attempts by Dealers to include arbitration in automotive franchise agreements which have been unsuccessful.

CONCLUSION

We would be happy to meet with you to discuss our submission and participate in any further consultation. If you require further information or clarification in respect of any matters raised, please do not hesitate to contact me.

James Voortman
Chief Executive Officer
M:
E:

REFERENCES

1 - 'Motor Industry Update', Pitcher Partners, Steven Bragg, John Gavljak & Aidan Cousin, September 2023

2 - https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3015515

https://www.legalmondo.com/2020/02/germany-distribution-franchise-agreements-goodwill-indemnity-termination/

https://www.dentons.com/en/insights/alerts/2020/june/24/new-dutch-franchise-law-mandatory-for-almost-all

APPENDIX A

AUTOMOTIVE-SPECIFIC FRANCHISE LAWS IN THE UNITED STATES

Every state in the United States has recognised the power imbalance between car manufacturers and car dealers by developing automotive-specific franchising laws which regulate manufacturer/dealer relations. While there are slight differences between the various state laws, they generally cover the following elements:

- Prevent dealership terminations except for "good cause."
- In the event of termination, the laws specify the kind of compensation required
- Upon non-renewal buy back of vehicles, parts, accessories, special tools and equipment
- Relevant Market Areas (RMAs) grant a dealer or group of dealers' exclusive territorial rights by preventing the manufacturer from establishing additional dealerships within a given geographical area.
- Outlaws price discrimination by OEMs to dealers
- Make it illegal for OEMs to force dealers to take vehicles they have not ordered
- Stipulates payment required for parts and Labor associated with warranty
- Restrict manufacturers from selling directly to the public.

LINKS TO SELECTED STATE AUTOMOTIVE FRANCHISING LAWS

California - https://law.justia.com/codes/california/2016/code-veh/division-5/chapter-4/article-1/section-11713.3

Maryland - http://www.mdautodealerlaw.com/dealer-franchise-laws.html

Illinois - https://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2382&ChapterID=67

Virginia - https://vada.com/dealer-resources/vada-law-book/

Michigan - https://paulruschmann.com/about/mi_auto_franchise.pdf

APPENDIX B

AADA 2023 Franchising Code Review Submission

Adequacy of protection of goodwill

1. The AADA considers that the Franchising Code is ineffectual in protecting the goodwill that dealers invest in when buying and developing their dealership businesses and is in need of reform in this regard. Even the recent addition of clause 46A in the Franchising Code does not provide adequate protections to dealers with respect to the loss of opportunity in selling established goodwill in the circumstances described in that clause.

2. The need for protection of dealership goodwill has been brought into sharp focus by the recent trend in Australia for distributors to convert their distribution models from a dealership model to an agency model (see for instance, Honda & Mercedes-Benz). Also, the recent case before the Federal Court in which Mercedes-Benz dealers unsuccessfully sought compensation from Mercedes-Benz Australia for converting their dealerships to an agency model[1] demonstrates the structural and situational vulnerability dealers find themselves in when a distributor seeks to convert their dealership network into an agency network.

3. The dealers in the Mercedes-Benz case were seeking compensation from Mercedes-Benz Australia as a consequences of Mercedes-Benz Australia effectively appropriating the goodwill and economic benefits of their dealership by converting them to agency distributors.

4. Importantly, the presiding judge, in the Mercedes-Benz case, Justice Beach, identified a number of inadequacies in the Franchising Code with respect to the protection of goodwill. Also, when delivering his judgment, Justice Beach called for the Franchise Code to be reformed, where he stated:

   'given that the facts led to an adverse finding, further consideration needs to be given to the terms of the Franchising Code, which is a matter for another day and another forum'[2]

5. In dismissing the dealers' case, Justice Beach found that:

   a. MBA had a right to issue non renewal notices to the dealers and there was no implied restriction to that power including for the purpose of converting the dealers to agents;

   b. *'the absence of any right at law for a franchisee to be compensated for goodwill on the non-renewal of a franchise agreement has long been recognised'*[3]

   c. MBA acted in good faith;

   d. the dealer's were not under economic duress when deciding whether to accept the agency agreement offered to them by MBA; and

   e. MBA did not engage in unconscionable conduct in contravention of the Australian Consumer Law. This is despite Justice Beach finding that:

      '… the shift to the agency model was in large part a case of franchisor opportunism because [Mercedes-Benz Australia] *took advantage of its position after the dealers had made significant investments, and it*

[1] Para 2209.
[2] ##.
[3] 125 abridged judgment.

intended to appropriate the gains in the industry margins associated with the move to the agency model; and

f. no right to compensation for goodwill has been included in the Franchising Code. Rather, a franchisor is only required to disclose 'the prospective franchisee's rights relating to any goodwill generated by the franchisee (including, if the franchisee does not have a right to any goodwill, a statement to that effect)'.[4]

6. The importance of goodwill to dealers cannot be understated. Apart from the capital investment dealers makes in their business, goodwill is the other significant investment dealers make. Dealers pay for goodwill when purchasing a dealership from another dealer and they also make ongoing financial investments in their goodwill by developing their dealership business including their customer relationships.

7. When purchasing a dealership from another dealer, dealers will pay for goodwill based on a multiple of the profit or earnings of the dealership. The 'multiple' paid will depend on a number of factors including whether or not it is a prestige brand and the location of the dealership. The value of a goodwill paid by dealers is very often in the millions of dollars, therefore making it a significantly material investment for a dealer.

8. Importantly, the goodwill of the dealership is not valued or based on the earnings that can be derived on the balance of the term that is being sought to be transferred as part of the sale. This is because, when the distributor consents to the proposed purchaser, it also offers to the purchaser the right to a new term of a dealer agreement. Dealers therefore pay for goodwill based on a multiple of earnings knowing that they will be obtaining a new term and that subject to the dealers meeting its performance targets, it will be offered a new dealer agreement or have the term renewed if the agreement has a right to renewal.

9. It follows that where a dealer is faced with not being offered a new agreement or renewal upon expiry, it faces a material loss in the established goodwill in which it has invested. Moreover, the loss is compounded by the fact in such circumstances the distributor generally grants another preferred dealer of its choice the right to operate in the territory operated by the former dealer, without having to pay anything to the former dealer. The new incoming dealer therefore obtains a financial windfall by acquiring the benefit of the goodwill developed in the territory of the former dealer without paying anything for it. Distributors recognise the financial detriment and inequity that this causes and, in some instances, permit dealers to sell their dealerships to another dealer (to recover their goodwill investment) upon being informed they will not be offered a new agreement. But this does not always happen and it is at the complete discretion of the distributor.

10. The financial detriment faced by franchisees in losing established goodwill has long being recognised by numerous government committees that have reviewed franchising in Australia. In particular:

a. in 1976 the Trade Practices Act Review Committee recommended in the Swanson Report that upon termination of franchises, the franchisee should be entitled to fair compensation for their investment, including goodwill upon termination of their franchises[5] on what the Court considers to be a just and equitable basis.[6];

b. in 1979, the Trade Practices Consultative Committee recommended in the Blunt Review *'that in both the assignment and the termination or non-renewal*

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[4] Para ## PJ.
[5] Trade Practices Act Review Committee, *Report to The Minister for Business and Consumer Affairs*, August 1976, [5.7].
[6] Ibid [5.13].

situations there be an apportionment of any goodwill between the franchisor and the franchise on the basis of the principle of fair apportionment having regard to the relative inputs of the franchisee and franchisor, both of capital (including general marketing costs which the franchisor may have incurred to promote the tradename, etc.) and labour, so that any goodwill is apportioned having regard to that relationship'.[7]

c. in 2008, the Parliamentary Joint Committee on Corporations and Financial Services produced a report entitled 'Opportunity not opportunism: improving conduct in Australian franchising'. The Committee considered the Swanson Report and Blunt Review[8] and stated as follows with respect to goodwill:

> *The present situation where a franchisee's contribution to their business has a market value prior to the end of the agreement which can be arbitrarily reduced to an amount determined by the franchisor afterwards is inequitable. At the end of an agreement, a franchisee has already committed considerably to the franchise system, financially and through their hard work, and is financially tied to the business. Franchisees stand to lose the prospect of returns on their capital investment, which in many cases is substantial.*[9]
>
> *The committee contends that a starting point for making an exit arrangement could be the market value of the business as a going concern.*[10]

11. One of the recent changes to the Franchising Code is the inclusion of clause 46A, which appears to be designed to compensate dealers for the loss of opportunity to sell established goodwill if there is an early termination of a dealer agreement in certain circumstances Clause 46A requires a dealer agreement to specify how the compensation for the early termination is to be determined, with specific reference to, among other things, loss of opportunity in selling established goodwill.[11]

12. It is apparent that clause 46A offers no practical protections to dealers who have a fixed term agreement with respect to compensating them for the loss of opportunity to sell established goodwill where there is a prescribed early termination event. This is because Justice Beach found in the Mercedes-Benz case that:

    a. there is no right for a franchisee to be compensated for goodwill on the non-renewal of a franchise agreement;[12]

    b. the Franchise Code does not include a right to compensation for goodwill;[13]

    c. with respect to clause 46A, the Franchising Code does not stipulate how compensation is to be calculated, only that the dealer agreement specify the franchisor's proposal**.**[14]

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[7] Trade Practices Consultative Committee, Small business and the Trade Practices Act, December 1979, [11.47].
[8] Page 24.
[9] Paragraph 6.87, Page 81.
[10] Paragraph 6.88, Page 81.
[11] Para ## above.
[12] Para ## above.
[13] Para ## PJ.
[14] Paragraph 2118, Long Judgement.

13. Also, in *Foxeden Pty Ltd v IOOF Building Society Ltd* [2003] VSC 356, the Court found that *'during the term of the franchise, the franchisee owns the goodwill of the franchise in the relevant sense and is able to sell the goodwill (by assigning the franchise agreement). In the absence of a contractual provision providing for compensation for goodwill on expiry or termination of the franchise, the franchisee will forfeit the goodwill'.*[15]

14. The practical effect of Justice Beach's findings and the Foxeden case is that if the dealer agreement only provides for the dealer be compensated for any established goodwill it has upon termination of the dealer agreement, then there will be no compensation.

15. The Mercedes Benz case clearly demonstrates the vulnerability of dealers to franchisor opportunism where distributors seek to convert their dealerships to agency arrangements. The current state of the law and the Franchising Code have proven inadequate for dealers to protect themselves. It is also for this reason that Justice Beach called for reform to the Franchising Code.

16. The AADA submits that a dealer's established goodwill ought to be protected by the Franchising Code given the significance of the investment and the manner in which dealerships are valued and traded. The AADA therefore proposes that the Franchising Code expressly recognise the right of dealers to be paid compensation for their established goodwill in circumstances where a new dealer agreement is not offered to a dealer or a renewal is granted or a clause 46A early termination even occurs. In particular, where a:

    a. new dealer agreement is not offered to a dealer or a renewal granted the distributor must:

        i. permit the dealer to sell its dealership within a prescribed period to another dealer approved by the distributor; or

        ii. pay compensation to the outgoing dealer for the loss of its established goodwill. If compensation is paid, the distributor would be entitled to recover the compensation from the incoming dealer taking over the outgoing dealer's allocated marketing territory;

    b. a new dealer agreement is not offered to a dealer or a renewal granted and the dealer is instead offered an agency agreement, the distributor be required to pay for the established goodwill of the dealer; and

    c. a clause 46A event occurs, the distributor must compensate the dealer for the loss of opportunity in selling the established goodwill.

17. In each of the circumstances described, the compensation to be paid for the established goodwill should be based on the direct sources of revenue and profit of the dealership in the 12 month period prior to the termination or expiration of the dealer agreement applying the average multiple in like branded dealership sale transactions in the previous 24 month period.

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[15] Page 269.

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