AUSTRALIAN AUTOMOTIVE DEALER ASSOCIATION

SUBMISSION: EXPOSURE DRAFT - CHANGES TO THE FRANCHISING CODE OF CONDUCT

11 DECEMBER 2020

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FOREWORD

The Australian Automotive Dealer Association (AADA) is the peak industry advocacy body exclusively representing franchised new car Dealers in Australia. We appreciate the opportunity to provide this submission to the Exposure Draft of changes to the Franchising Code of Conduct.

There are around 1,500 new car Dealers in Australia that operate more than 3,000 dealerships. The new vehicle retailing sector employs more than 55,000 people including 4,463 apprentices, contributes over $14 million in community donations nationally, has total turnover/sales of almost $56 billion and generates more than $2 billion in tax revenue.

These are important businesses which pay tax in Australia, create jobs in Australia, and invest in Australia.

For a number of years, the AADA has been calling for measures to address the power imbalance which exists between local Australian car Dealers and the car Manufacturers to which they are franchised. We continue to believe that we require separate protections from the standard franchising system due to the scale of the investments in this industry and the many factors that make the automotive supply chain unique. Not every Manufacturer treats its Dealers poorly, but the AADA is concerned over the growing reports we receive from Dealers aligned to various brands.

In the 2013 review of the Franchising Code of Conduct, Alan Wein observed:

> *"Regulation of an industry must give stakeholders certainty and confidence. The government's role is to provide protection for vulnerable groups and people, and to regulate against conduct and behaviour which is improper, unacceptable and unlawful. It should otherwise allow the parties to negotiate agreements between themselves, accepting all the risks, opportunities, benefits and liabilities which flow as a consequence."*

There is no question that with the imbalance in power that exists in the relationship between franchised new car Dealers and their large offshore Franchisors, Dealers are extremely vulnerable.

Evidence of this abounds with General Motors' (GM) recent decision to dump Holden and its Dealers, the most striking example of the poor behaviour exhibited by some offshore car Manufacturers. GM Holden led Dealers to believe that it was here for the long haul, demanding multi-million-dollar investments from some Dealers and allowing the sale of Dealerships to go through, not long before its announcement was made. In some cases, Dealers were forbidden by Holden from taking on other franchises. Even more shocking was the compensation offers which were grossly inadequate and left many businesses vulnerable.

The behaviour of GM Holden sets a very dangerous precedent and other Manufacturers looking to change their distribution model have now been given reason to adopt a similar approach. As an example, recent changes by Honda Australia to its retail network have resulted in the early termination of agreements which had years left to run. Like the terminated Holden Dealers, the compensation offered is woefully short of what was independently determined to be a fair amount.

In recent months, we have seen more Dealer terminations as well as a number of agreements being non-renewed, despite Dealers performing above the requirements set by Manufacturers.

Manufacturers in Australia operate in an environment which allows them to enter the market and rapidly appoint a network of Dealers. They benefit from the fact that Dealers take on the lion's share of the risk by investing in facilities, stock and equipment, hiring staff, etc. However, there is no mutual obligation for Manufacturers to treat these investors respectfully or fairly and it is easy for Manufacturers to withdraw from Australia, reduce their Dealer networks and radically change their distribution model.

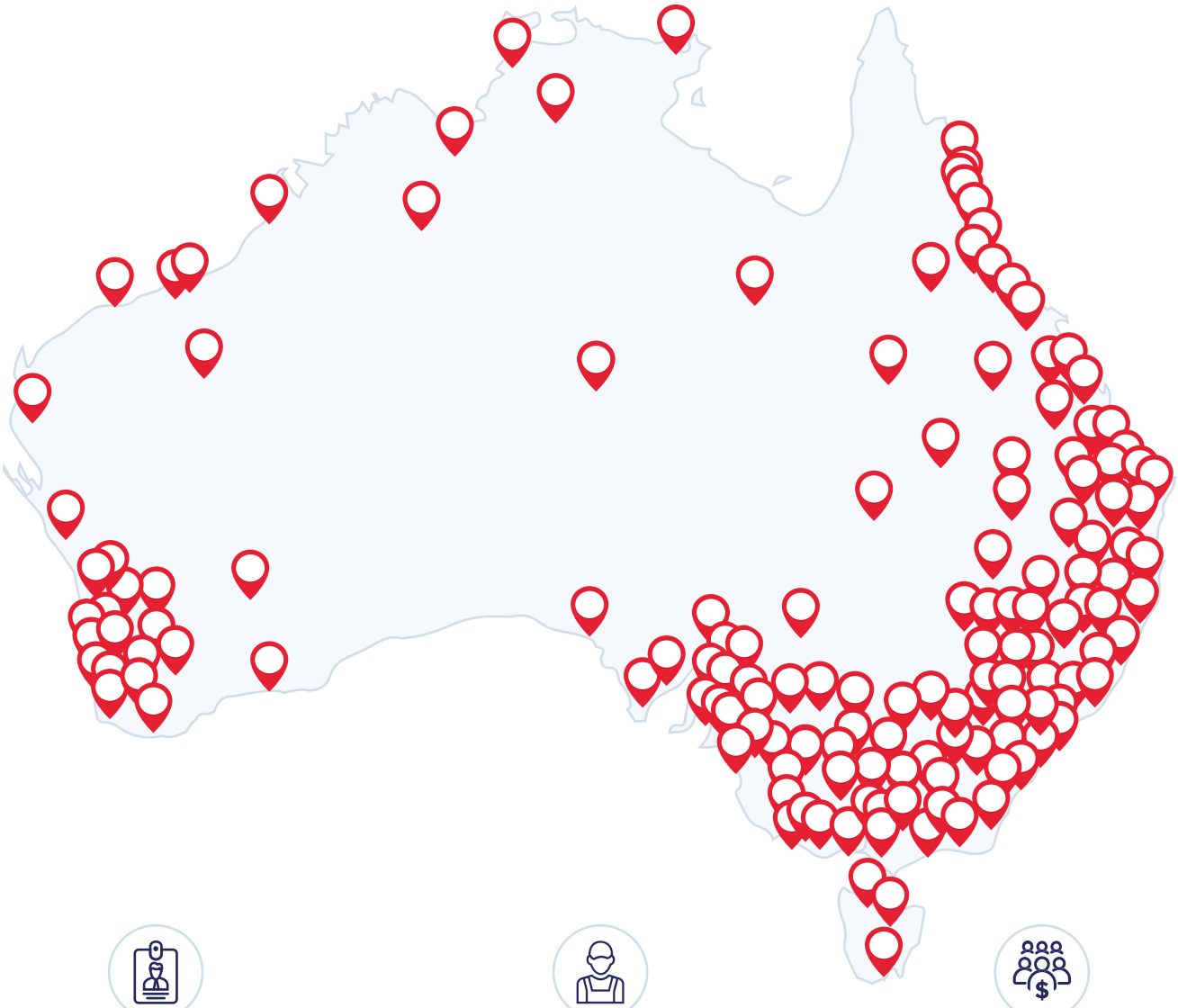
In June, the Government enacted automotive-specific franchising regulations under the Franchising Code – however only incremental changes were introduced, and the voluntary nature of the changes provides Manufacturers with options to avoid complying with the regulations.

The AADA is supportive of the intent of the draft changes but believes that they simply do not go far enough, lack enforceability and will in practical terms achieve nothing. Further, the penalty units described in the exposure draft are completely insignificant to the large offshore car makers who do business in this country and represent no deterrent. As an example, in the 2019 fiscal year General Motors generated revenue of $137 billion USD, Honda $143.1 billion USD in total with $99.8 billion coming from automotive while Mercedes-Benz improved on its previous year's results to $114.14 billion USD from its car division alone. For organisations of this size, a penalty of 300 or 600 units, equal to $133,200 AUD, would not even rate a mention in the annual reports.

James Voortman
Chief Executive Officer

Australia

3,135 Dealerships



55,815
Dealer Employees

4,463
Dealer Apprentices

$14.82 million
Community Donations

$5.10 billion
Dealer Wages

$2.07 billion
Tax Contribution

$12.76 billion
Total Economic Contribution

RESPONSES TO THE EXPOSURE DRAFT

ENTERING INTO A FRANCHISE AGREEMENT

1. Key Facts Sheet

The Key Facts Sheet and its content and format is not a high priority issue for franchised new car Dealers. Dealers entering or renewing Dealer agreements are committing to multi-million-dollar investments for which they typically obtain independent specialist accounting and legal advice. Of far greater importance, irrespective of the independent advice they receive, is the power imbalance which precludes them from being able to influence the agreement to make it fair. Agreements are offered to Dealers on a take it or leave it basis and a Dealer who has already invested in a brand and employs people in that business feels compelled to sign despite the agreement being strongly weighted in favour of the OEM.

2. Changes to Disclosure Document Requirements

Similar to the comments on Point 1. Dealers are well informed and have normally obtained professional advice regarding franchise agreements they are considering entering in to. The disclosure documents are of benefit to Dealers but they are not a high priority. For example, both Honda Australia and Holden terminated Dealer agreements at the direction of their overseas head offices with no prior warning to Dealers. In both examples it is highly likely that such big business decisions would have been made months if not years before. It is difficult to conceive of how a disclosure agreement, had one been in place, could have prevented these terminations occurring.

3. Significant Capital Expenditure

Given that capital expenditure for Dealers often extends to tens of millions of dollars, the requirement to disclose this is very important, though the requirement to discuss prior to agreeing is largely pointless given the power imbalance, the investment in the brand that a Dealer has already undertaken and the historical evidence showing OEMs are not compelled to change their offer. Discussing the expenditure beforehand is likely to be an exercise in futility.

4. Supplier Rebates

A condition of Dealer Agreements and their associated operations manuals is that Dealers will purchase, at their expense, very expensive special tools and equipment prescribed by the OEM. Often Dealers are also expected to agree to purchase products like workshop consumables from suppliers who have struck side agreements with the OEM.

Targets and KPIs are set for Dealers across a wide range of metrics obtained from analysis of Dealer operations in the customer service, sales, parts, service and finance and insurance departments. Achieving targets is critical for a Dealer and the financial incentives to do so can amount to hundreds of thousands of dollars in incentive payments without which many Dealers cannot operate profitably. A Dealer choosing not to purchase from OEM appointed suppliers can suffer serious repercussions. Failure to achieve targets in just one of these areas can result in a Dealer being determined ineligible for receiving any incentive payments.

The requirement for franchisors to disclose the rebates contained in these deals therefore becomes very important for Dealers and we strongly support this change to the Code.

5. Changes to the Information Statement

The AADA is supportive of this change and more generally of any change which provides prospective franchisees with more information about the franchise and agreement they are entering in to.

6. Leasing of Premises

Franchisees leasing premises off franchisors is not a feature of the new car retailing industry though as mentioned, AADA is supportive of any improvements that provide franchisees or prospective franchisees with more information regarding the franchise agreement.

OPERATING A FRANCHISE

1. Restriction on Passing on Legal Costs

Though not regularly a feature in automotive franchising, the AADA fully supports restrictions on franchisors preventing them from passing on legal costs.

2. Retrospective Variation

Changes restricting franchisors from being able to unilaterally vary the terms of the agreement are strongly supported, however in automotive franchising terms are often varied midterm through changes to operations manuals, sales bulletins, technical service and warranty bulletins and sometimes even by letters sent to Dealers directly by the OEM. Section 31A, under Schedule 7 of the Exposure Draft completely fails to recognise these alternate channels which are referred to in the master agreements and liable to variation at any time. Agreement terms are regularly changed through these mechanisms and the changes can drastically influence and impact upon the Dealer. It is essential that the draft legislation comprehensively cover all materials that establish a franchise agreement. This is yet another example of where the Exposure Draft includes provisions that are easily worked around and avoided by the OEMs.

3. Marketing and Cooperative Funds

The AADA supports full transparency and financial reporting in all areas of expense concerning any contributions by franchisees to co-operative funds, marketing and advertising.

ENDING THE FRANCHISE RELATIONSHIP

1. Cooling Off

As discussed earlier, Dealers entering franchise agreements are typically well informed and have completed extensive due diligence. Equally, while Dealers incur large sums of money to be part of a franchise, they do not pay franchise fees per se. A cooling off period is of negligible benefit or value in automotive franchising.

2. Early Exit

The AADA is supportive of the early exit provisions though they will have little application in automotive franchising as Dealer agreements generally include clauses allowing this. The most important and relevant aspect of this is what compensation, if any, is given to a Dealer when an agreement ends, for any reason, and what becomes of the vehicle and parts inventory.

3. Termination

Termination provisions predicated on being able to appeal the decision through a dispute resolution process that is voluntary are meaningless. Both Honda and Holden have proven that franchisors have the ability to terminate agreements at will, en masse and under arrangements entirely of their making. The new termination provisions have no power to change this, fail to provide for a punitive deterrent sufficient to discourage it and give the franchisee no guarantee of compensation when termination by the franchisor occurs.

4. Restraints of Trade

Not commonly applicable in automotive franchising.

5. Dispute Resolution

Voluntary arbitration in any form is of no use in protecting the rights of franchised new car Dealers. This was demonstrated during the Holden closure in which Holden management refused to enter into arbitration with 185 Dealers and summarily dismissed and ignored calls from a senior government minister to do so. Dealers unable to resolve disputes with OEMs have no alternative than to take action in the courts, which given the power imbalance is a long and prohibitively expensive process which few can realistically consider and even fewer can endure. Arbitration should, by design, serve as the safety net underpinning all sections of the Franchising Code. As a voluntary provision it renders breaches of nearly all franchisor obligations in the Code inconsequential and ultimately unenforceable.

APPLICATION AND COMMENCEMENT DATES

The AADA is agreeable to the dates proposed.

REGULATORY FRAMEWORK – DOUBLING PENALTIES

Doubling the penalties is emphatically no deterrent to large offshore vehicles Manufacturers turning over hundreds of billions of dollars a year. These penalties are laughable for these organisations.

CONCLUSION

The intent of the provisions contained in the exposure draft are sound, however they will deliver no benefit to franchisees in the automotive franchising sector. Many of the clauses do nothing more than fiddle at the edges of the real issues which stem from the power imbalance. The egregious and exploitative behaviour demonstrated by many of the OEMs towards their Dealers give these franchisors little incentive to change their behaviour and franchisees heavily invested in a franchise are effectively powerless to negotiate a fairer deal without going to court. If court action is the only alternative, then why bother having a Franchising Code at all? A Franchising Code which protects franchisees is desperately and urgently needed but Australian Dealers will continue to suffer and fail until there are none left, or the Code is given the teeth it deserves.

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