



# Regulation Impact Statement – franchise relationships between car manufacturers and new car dealers

ACCC submission

13 February 2019

## 1. Introduction

The Australian Competition and Consumer Commission (ACCC) appreciates the opportunity to respond to the Regulation Impact Statement (RIS) regarding franchise relationships between car manufacturers and new car dealers.

The ACCC is an independent Commonwealth statutory authority whose role is to enforce the *Competition and Consumer Act 2010* (CCA) and a range of additional legislation, promoting competition, fair trading and regulating national infrastructure for the benefit of all Australians. The ACCC takes action to improve consumer welfare, promote competition or stop conduct that is anti-competitive, and to promote the proper functioning of Australian markets.

The ACCC's market study into the new car retailing industry (market study) highlighted a number of systemic problems in the sector. In particular, the December 2017 [final report](#) for the market study found that while the Australian Consumer Law (ACL) provides protections to consumers through the consumer guarantees provisions, there are a number of problems in the new car industry preventing consumers from obtaining the remedies to which they are entitled.<sup>1</sup> One of these problems was identified as the power imbalance between car manufacturers and their dealers, in favour of the car manufacturer. This imbalance means that car manufacturers are able to impose commercial terms on dealers which have the effect of making it difficult for dealers to provide satisfactory outcomes for consumers.

## 2. Systemic problems identified in the ACCC market study

During the market study, several stakeholders called for the ACCC to undertake further analysis of the commercial arrangements between manufacturers and dealers, including to assess whether these arrangements influence the approach of dealers to consumer guarantee and warranty claims.

The market study focussed on features of commercial arrangements between manufacturers and dealers which may impact on ACL compliance, in particular the ability of consumers to exercise their consumer guarantee and warranty rights.

The dealer agreement is the core contract between the manufacturer and authorised dealer which establishes the obligations of each party in relation to sales, parts and service facilities. During the market study, the ACCC examined a range of dealer agreements and manufacturers' policies and procedure manuals from brands representing approximately 75 per cent of new car sales in Australia.

From the information provided to the market study, we consider that the following key factors contribute to an imbalance in bargaining power between manufacturers and dealers (in favour of manufacturers):

- Dealers are offered contracts on a 'take it or leave it' basis.<sup>2</sup>
- Significant upfront capital investment is involved in establishing new dealership facilities, with estimates provided in the range of \$6 to \$20 million,<sup>3</sup> depending on the metropolitan or regional location of the dealership.

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<sup>1</sup> ACCC, New car retailing industry market study, [final report](#), 14 December 2017.

<sup>2</sup> NSW Small Business Commission [submission](#) to the ACCC market study, November 2016, p. 2.

<sup>3</sup> *IBISWorld Industry Report G3911 Motor Vehicle Dealers in Australia*, February 2017; Fennessy's [submission](#) to the ACCC market study, October 2017, p.2.

- The length of the initial and subsequent tenure of dealership agreements is typically of relatively short duration, in most cases one to five years, and often does not enable the dealer to recoup the capital they have invested before the end of the relevant term.
- Dealers do not have security of tenure and in most cases renewal of the agreement is at the absolute discretion of the manufacturer.

Dealer representative bodies submitted that given these features, dealers are financially vulnerable and beholden to manufacturers.<sup>4</sup> Based on information provided to the market study, we consider that the combination of large upfront investment costs, short duration of tenure, and absence of security of tenure, may place dealers under commercial pressure to accede to and obey the instructions of manufacturers in order to maximise their prospects of renewal.

Supporting this conclusion, the Australian Automotive Dealer Association submitted that conduct by dealers that runs contrary to the instructions or express wishes of manufacturers risks a dealer's investment in their franchise business. Similarly, the Motor Trades Association of Australia submitted that dealer agreements restrict the independence of dealers, and that the imbalance in power between manufacturers and dealers can negatively impact consumers, but not necessarily at the fault of dealers.<sup>5</sup>

The market study found that manufacturers exert a substantial level of control over how dealers handle consumer guarantee and warranty claims which can constrain the ability of dealers to provide a remedy or discourage dealers from raising claims with manufacturers.

### 3. The RIS policy options

#### The RIS policy options identified as having a 'net benefit'

The RIS identifies the following four options as having a positive net benefit.

**Option 2A: Requiring manufacturers to provide at least 12 months' notice when not renewing a dealer agreement.**

**Option 2B: Requiring manufacturers to provide a statement to a dealer whose agreement is not being renewed outlining why the agreement is not being renewed.**

**Option 2D: Requiring pre-contractual disclosure of significant capital expenditure to have a greater degree of specificity.**

**Option 2F: Enabling multi-franchise mediation.**

#### ACCC response:

The ACCC supports these four options as proportionate interventions that will assist in addressing an imbalance of power between manufacturers and dealers. While these interventions alone will not address all issues arising from that power imbalance, the ACCC considers the four options are relatively straightforward solutions that impose a minimal burden on industry. The ACCC also recommends that Options 2B, 2D and 2F be implemented more broadly for the franchising industry, as changes to the Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (**Franchising Code**).

<sup>4</sup> MTA NSW submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct, July 2008, p. 13, available [here](#).

<sup>5</sup> MTAA [submission](#) to the ACCC market study, November 2016, pp. 4 and 9.

The ACCC considers that these changes would be beneficial beyond the new car retailing industry and franchisees more generally would benefit from these amendments. The ACCC's views on implementation options are briefly discussed in Part 4 below.

The policy options will increase disclosure and transparency requirements to enable better decision-making and transparent dealings, as well as enable more efficient and effective dispute resolution among parties.

### **Option 2B**

The Franchising Code's primary purpose is to address the stronger bargaining power enjoyed by Franchisors in their dealings with Franchisees. The Franchising Code currently governs the termination of a franchising agreement by a franchisor, but does not cover circumstances in which a franchisee's agreement is not renewed.

For many businesses, including car dealers, non-renewal of a franchising agreement can be just as detrimental as termination, especially when the franchisee expects the franchisor to renew the agreement, as may have been done routinely on previous occasions. This is especially so if previous renewals have lulled the dealer into not taking steps to minimise exposure if the agreement is not renewed.

The proposed Option 2B would effectively extend some obligations that currently apply to termination of an agreement to renewal, benefiting businesses in industries where non-renewal is particularly detrimental, while at the same time providing greater transparency to all franchisees.

### **Option 2D**

The ACCC's May 2018 submission to the Parliamentary Joint Committee (PJC) inquiry into the operation and effectiveness of the Franchising Code recommended amendments to the Franchising Code to ensure meaningful disclosure about establishment costs and other anticipated recurring or one-off costs. The ACCC similarly considers that pre-contractual disclosure of significant capital expenditure must be meaningful, as opposed to very wide ranges of cost estimates that have the effect of providing almost meaningless information. This disclosure should include the facts and assumptions underlying cost ranges and the average / median costs of capital expenditure based on comparative examples for similar capital expenditure undertaken by other authorised dealers in the same network.

The ACCC also considers that Option 2D should be extended to require a greater degree of specificity in the pre-contractual disclosure of arrangements that will apply at the end of the dealership agreement for unsold stock, ancillary equipment and other assets. Pre-contractual disclosure of end of term arrangements should cover what will happen to unsold stock, equipment and other assets that are supplied by the manufacturer to the dealer, or which are otherwise obtained with the manufacturer's approval or under the manufacturer's operation specifications. To ensure dealers are fully informed, such disclosure should be explicit as to whether the manufacturer will purchase, or otherwise nominate a purchaser for, unsold stock, equipment and other assets and detail how prices will be determined, consistent with existing obligations under the Franchising Code. As for significant capital expenditure, detailed information about the methodology for determining prices for unsold stock, equipment and other assets should be disclosed to dealers.

### **Option 2F**

The ACCC recommends that Option 2F be implemented by way of amendments to the Franchising Code so that it applies to all franchising agreements.

Mediation is useful to dispute resolution in all franchising relationship because the parties need to continue a good working relationship after their dispute is resolved and litigation can involve high costs for the individual franchisee. This is not unique to franchising agreements in the new car retailing industry. In the ACCC's compliance and enforcement experience, it is not uncommon for multiple franchisees to have similar disputes with their franchisor.

Multi-party mediation has a number of benefits such as:

- assisting to shift the imbalance of bargaining power between a Franchisor and their franchisees when resolving disputes.
- a more efficient process and use of resources.

The ACCC's submission to the PJC inquiry into the operation and effectiveness of the Franchising Code noted that the application of a multi-party mediation provision would need to be considered in conjunction with the other requirements under the Franchising Code. For example, that parties not be compelled to attend mediation in states and territories other than where their franchised business is based.<sup>6</sup>

The ACCC supports Option 2F as it will provide better facilitate dispute resolution under the Franchise Code.

### The RIS policy options *not* identified as having a net benefit

The RIS identifies three other policy options for reform that are considered unlikely to have a positive net benefit (Options 2C and 2E are considered immediately below, followed by a discussion of Option 3).

**Option 2C: Mandating that manufacturers buy back stock when an agreement is not renewed.**

**Option 2E: Minimum five year terms with right of renewal.**

#### **ACCC response:**

Options 2C and 2E would impose a greater burden on manufacturers, in particular, by restricting their flexibility in making changes to their authorised dealer networks.

Option 2C would require manufacturers to purchase remaining stock in the context of non-renewal of a dealer agreement, with the price of the stock to be negotiated by the parties after the notice of non-renewal is served. The ACCC notes that disclosure of outlay required by franchisees, and details for arrangements for unsold stock, equipment and other assets at the end of a franchise agreement are to be disclosed to franchisees under the Franchising Code, prior to a franchise coming into effect. However, this does not extend to any requirement upon franchisors to buy back stock when an agreement expires or terminates. The RIS notes that some existing dealer agreements do require manufacturers to buy back stock when an agreement expires or is terminated, however, not all agreements contain these provisions. In the event that a requirement was introduced to mandate that manufacturers buy back stock when an agreement is not renewed, floorplan or bailment financing arrangements typically used by dealerships are a relevant consideration. Floorplan or bailment financing involves dealers taking possession, but not ownership of showroom vehicles and the financier retains ownership of the motor vehicle until sold.

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<sup>6</sup> See the ACCC's May 2018 [submission](#) to the Parliamentary Joint Committee's inquiry into the operation and effectiveness of the Franchising Code of Conduct, at page 12.

Option 2E, a required minimum term for dealer agreements, has a primary objective of allowing dealers a sufficient period in which to recoup capital investment required by the manufacturer. The RIS notes that stakeholder feedback indicates that the majority of dealer agreements currently have five year terms with the franchisor having the option to renew the agreement. On this basis, this option would be broadly consistent with current industry practice, but would provide the franchisee with the option to renew, rather than the franchisor. The RIS notes that an alternative option, which stakeholders are invited to provide feedback on, would be to link the term of a new agreement to the amount of capital expenditure undertaken.

The ACCC has previously highlighted that, in particular, a lack of security of tenure in dealership agreements appears to be a central driver of an imbalance in bargaining power between dealers and manufacturers. The market study highlighted that a key reason for the imbalance in bargaining position between manufacturers and dealers is the:

- significant capital investment involved in establishing or upgrading dealership facilities, and
- relatively short duration of the initial and subsequent tenure of dealership agreements, which often does not enable dealers to recoup the capital investment before the end of the relevant term.

Dealer representative bodies submitted that given these features, dealers are financially vulnerable and beholden to manufacturers.

The ACCC notes that it is rare for minimum tenure and right of renewal to be afforded to businesses, as a regulatory requirement, although this is the case for fuel re-selling agreements. Fuel re-selling agreements entered into after the commencement of the Oil Code must have a minimum term of five years, subject to certain exceptions.

The Franchising Code does not offer minimum tenure and right of renewal, instead providing for minimum notice requirements, for non-renewal, and disclosing what arrangements will apply at the end of a franchise agreement. In general, the Franchising Code focuses on improving disclosure of material information and providing a mechanism for dispute resolution, rather than altering contractual terms between franchisors and franchisees. Previous inquiries into franchising did not support a right of renewal. The duration of the agreement entered into may be relevant to considering whether any other terms of a dealer agreement could constitute unfair contract terms – assuming dealers meet the B2B UCT thresholds (currently the subject of review by Treasury).

The market study recommended that certain issues raised by dealers in relation to an imbalance of power in their commercial arrangements with manufacturers required further examination, including a required minimum term for dealer agreements. However, the market study did not consider the pros and cons of introducing minimum term requirements and stock buy-back of stock requirements more broadly. While the ACCC considers that an imbalance of power underpins commercial arrangements between manufacturers and dealers, the ACCC does not have a concluded view as to whether minimum tenure and buy-back of stock requirements are necessary or appropriate to address such an imbalance.

### Option 3: Voluntary Code of Conduct.

#### ACCC response:

Option 3 would introduce a voluntary code of conduct under which industry players would implement the policy options that are considered to be of net benefit.

The ACCC does not support a voluntary code of conduct. The ACCC considers that mandatory solutions are required to overcome entrenched conduct in the new car retailing industry. A voluntary code is unlikely to resolve issues when there is a significant imbalance in power between parties. For example, as noted in our market study, we consider the earlier attempt to encourage car manufacturers to voluntarily share technical information has failed.

The ACCC agrees with the views expressed in the RIS that given voluntary approaches to franchising regulation failed, it appears unlikely that Option 3 would effectively address the identified problems.

## 4. Implementation options

Implementation options canvassed in the RIS include:

- amendments to the Franchising Code that would have economy-wide application,
- a new schedule to the Franchising Code specifically regulating the new car retailing industry, or
- a new stand-alone Automotive Code under the CCA.

As noted above, the ACCC supports the implementation of the policy options identified as being of 'net benefit' – and recommends that Option 2D be extended to disclosure of end of term arrangements for unsold stock, equipment and other assets. The ACCC considers that these changes should be implemented by way of general amendments to the Franchising Code.

The ACCC agrees with the RIS's conclusion that these are likely to be of net benefit. The ACCC considers that there is benefit in these policy options having broader application across the economy, to increase disclosure and transparency requirements and enable more efficient and effective dispute resolution in other industries that may suffer from similar problems.

General amendments to the Franchising Code would also minimise any risk of a new regulatory framework specific to a specific industry becoming outdated over time. For example, the ACCC's submission to the PJC inquiry into the operation and effectiveness of the Franchising Code outlined that the Oil Code, which was initially intended to build upon and strengthen relevant provisions from the Franchising Code, failed to incorporate subsequent reforms regarding disclosure, marketing funds and termination. Over time, the Oil Code has 'fallen behind the Franchising Code'<sup>7</sup>.

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<sup>7</sup> See the ACCC's May 2018 [submission](#) to the Parliamentary Joint Committee's inquiry into the operation and effectiveness of the Franchising Code of Conduct, at page 12.

The ACCC considers that of the policy options identified as being of 'net benefit', it may be appropriate that Option 2A (requiring manufacturers to provide at least 12 months' notice when not renewing a dealer agreement) has specific application to the new car retailing industry. This is on the basis that 12 months' notice when not renewing a dealer agreement is appropriate for this industry given the significant capital expenditure and value of goods sold. The ACCC considers that in implementing Option 2A, rather than introducing a new schedule to the Franchising Code, an alternative and more appropriate option would be to add a provision in the Franchising Code requiring at least 12 months notice for non-renewal of motor vehicle dealership agreements. The ACCC notes that the Franchising Code explicitly lists motor vehicle dealership agreements as an agreement which is taken to be a franchise agreement and for this reason, 'motor vehicle dealership' is already a defined term.

The ACCC also notes that regardless of the implementation method ultimately selected, there are likely to be resource implications for the ACCC. Codes are only effective to the extent they can be enforced, and any new obligations will mean additional resources will be required for the ACCC to undertake enforcement work in relation to the new obligations. Additionally, the ACCC will need to undertake education and compliance work to ensure market participants are aware of any new obligations.

### **Comments regarding a potential stand-alone Automotive Code under the CCA**

In the event that a stand-alone Automotive Code is to be introduced as a mandatory code, the ACCC considers that any new stand-alone code should be readily capable of being enforced. As noted in the ACCC's submission to the PJC inquiry into the operation and effectiveness of the Franchising Code,<sup>8</sup> the ACCC's experience indicates that even when a code is successful in lifting the standards of behaviour across a sector generally, there will always be those that do not comply. For example, in the context of the Franchising Code, while the ACCC is not a franchise dispute resolution body, in our role of enforcing compliance with the Code it is critical that we are able to ensure that significant and systemic instances of non-compliance with that Code are identified, investigated and appropriate enforcement action is taken.

For Codes to be effective, the consequences of breaching the Codes must be sufficiently serious to incentivise compliance. Where penalties are too low, parties that are subject of those Codes (in this case, car manufacturers and new car dealers), are likely to factor the risk of a penalty in as a cost of doing business. Where penalties are unavailable there is no incentive for a party that is subject of the Code to comply with the Code.

If a stand-alone Automotive Code is introduced, it must include adequate penalties to ensure it can be enforced and to ensure there are appropriate incentives to generate compliance. The ACCC considers that our recommended amendments to the Franchising Code as set out in our submission to the PJC inquiry into the operation and effectiveness of the Franchising Code, should also be incorporated into any stand-alone Automotive Code, if that implementation method is ultimately chosen. In particular, civil pecuniary penalties and infringement notices should be made available for all breaches of any new Automotive Code. Meaningful penalties for all breaches of any new Automotive Code would significantly improve our ability to enforce it and improve conduct in the sector.

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<sup>8</sup> See the ACCC's May 2018 [submission](#) to the Parliamentary Joint Committee's inquiry into the operation and effectiveness of the Franchising Code of Conduct.